SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 510

MARKET STREET RAILWAY COMPANY,
Appellant,

vs.

RAILROAD COMMISSION OF THE STATE OF CALIFORNIA, FRANCK R. HAVENNER, C. C. BAKER, ET AL.

APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA.

STATEMENT AS TO JURISDICTION

CYRIL APPEL,
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SUPREME COURT OF THE UNITED STATES

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No. 510

MARKET STREET RAILWAY COMPANY,
Appellant,

vs.

RAILROAD COMMISSION OF THE STATE OF CALIFORNIA AND FRANCK R. HAVENNER, C. C. BAKER, JUSTUS F. CRAEMER, RICHARD SACHSE AND FRANK W. CLARK, THE MEMBERS OF AND CONSTITUTING THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA,
Appellees.

STATEMENT AS TO JURISDICTION

Statement of the Case

Appellant is a public utility street railway company operating in the City and County of San Francisco and the County of San Mateo. It is subject to the jurisdiction of the California Railroad Commission under the provisions of the Public Utilities Act of the State of California.[1] The instant case originated before the Railroad Commission by an order, made on the Commission's own motion, instituting

[1] California Statutes, 1915, p. 115, as amended; Deering's California General Laws, Act 6386.

an investigation "into the reasonableness of the rates, charges, classifications, rules and regulations of the Market Street Railway Company, and also into the reasonableness, sufficiency and adequacy of the operations, service and facilities of said company."[2] Although this order, in the broad form conventionally used, referred generally to rates, the evidence at the hearings—which covered only three days, May 10, July 15, and September 15, 1943—was directed to matters relating to improvement of service.[3] At no stage in the proceedings was there any issue formulated with respect to rates; at no stage was there any definite complaint or allegation that any rate was unreasonable. At no time prior to the decision did the Commission advise appellant that its rates were in issue, or under attack, or that any change in them was proposed. The testimony was general, relating except in incidental respects to service. Evidence customary in a rate case is entirely absent.

After the hearings the Commission filed an order directing appellant to reduce its fares from 7 cents to 6 cents. Appellant promptly filed a petition for rehearing,[4] alleging specifically and in appropriate detail,[5] that the Commission's order was invalid under the due process of law clause of the Fourteenth Amendment for the reason that it was entered without notice and opportunity for a hearing, that it was not supported by substantial evidence, and that it was confiscatory and constituted the taking of appellant's property. The Commission denied the petition for rehearing with opinion. In this opinion, which is attached hereto

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[2] Exhibit A to Petition for Writ of Review.

[3] See statements of the members of the Commission and of the Commission's engineer, Exhibit E to the Petition for Writ of Review.

[4] Exhibit C to Petition for Writ of Review.

[5] See paragraphs II, III and IV of the Petition for Rehearing, which is a part of the record herein as Exhibit C to appellant's Petition for Writ of Review.

as Exhibit 2, the Commission expressly passed upon the Federal questions and sustained the validity of its order as against the attack based on the Federal constitution.

Thereafter pursuant to sections 67, 68, and 69 of the Public Utilities Act of California, *supra*, appellant filed its petition for writ of review in the Supreme Court of the State of California, specifically repeating its attack upon the validity of the Commission's order under the due process of law clause of the Fourteenth Amendment. The court granted the petition and the cause was heard upon the return of the Commission to the writ of review. Thereafter, on July 1, 1944, the court affirmed the order of the Commission. The opinion of the court, which is attached hereto as Appendix 3, expressly passed upon the Federal questions and sustained the validity of the Commission's order as against appellant's claim that it is repugnant to the due process clause of the Fourteenth Amendment. Appellant's petition for a rehearing of the decision and judgment of the Supreme Court of the State of California was denied by that court without opinion on July 27, 1944.

Opinions Below

The opinion of the Railroad Commission, together with two concurring opinions, is attached hereto as Appendix 1. The opinion of the Railroad Commission on rehearing is attached hereto as Appendix 2. The opinion of the Supreme Court of the State of California is attached hereto as Appendix 3.

Statutory Provision Sustaining Jurisdiction

The statutory provision believed to sustain the jurisdiction of this Court is section 237(a) of the Judicial Code, as amended by the Act of February 13, 1925, and the Act of January 31, 1928 (28 U. S. C., secs. 344(a), 861a).

Statute of the State Involved

The statute of the State, the validity of which is involved, is the order of the Railroad Commission in this proceeding. This order is copied in full at the end of the majority opinion of the Railroad Commission in Appendix 1 attached hereto.

Date of Judgment and of Application for Appeal

The opinion and judgment of the Supreme Court of the State of California was rendered July 1, 1944 (Appendix 3 hereto). A petition for rehearing was denied July 27, 1944. The application for appeal was presented July 31, 1944.

Cases Believed to Sustain Jurisdiction

The cases believed to sustain the jurisdiction of this Court are:

Bluefield Co. v. *Pub. Serv. Comm.*, 262 U. S. 679, 683;
Nor. Pacific v. *Dept. Public Works*, 268 U. S. 39, 42;
King Mfg. Co. v. *Augusta*, 277 U. S. 100, 114;
Ohio Bell Tel. Co. v. *Comm'n.*, 301 U. S. 292, 298-300;
American Bridge Co. v. *Comm'n.*, 307 U. S. 486, 487.

Raising the Federal Questions

In paragraphs II, III, and IV of appellant's petition for a rehearing filed with the Railroad Commission,[6] appellant attacked the validity of the Commission's order under the due process of law clause of the Fourteenth Amendment to the Federal constitution on the several grounds already stated. In its opinion on rehearing the Commission set forth these grounds of attack, pointing out that for the reasons stated therein "our order is alleged to be in violation * * * of the Fourteenth Amendment to the Constitution of the

[6] See footnote 5, supra.

United States"; and it sustained the validity of the order as against this attack.[7]

In its petition for writ of review in the Supreme Court of the State of California, appellant specifically renewed its attack on the validity of the Commission's order under the Fourteenth Amendment. Paragraphs IX, X and XI of this petition read in part as follows:

"IX

In issuing said Decision No. 36739, the Railroad Commission has not regularly pursued its authority, and has denied petitioner due process of law contrary to the Constitution of the State of California and the Fourteenth Amendment to the Constitution of the United States, in that the Railroad Commission has ordered petitioner to reduce its rates or fares (1) without first giving petitioner notice that it was being charged with the maintenance of rates that were unreasonable or in any other respect unlawful because in violation of the provisions of the Public Utilities Act, (2) without declaring or framing the issue of unreasonable rates during the course of the hearings had in said proceeding, and (3) without according petitioner a hearing upon such issue. In this regard petitioner alleges and shows as follows: [here follow detailed specifications].

X

In issuing said Decision No. 36739 the Railroad Commission has not regularly pursued its authority, and has denied petitioner due process of law in violation of its rights under the Constitution of the State of California and the Fourteenth Amendment to the Constitution of the United States, and has acted arbitrarily and capriciously, in that it has made an order reducing petitioner's rates without having substantial or any evidence before it that the rates now charged are in

[7] Opinion on Petition for Rehearing, Exhibit 2 attached hereto.

any respect unreasonable or that a lower rate would be reasonable for the future. In this regard petitioner alleges and shows: [here follow detailed specification].

XI

In issuing said Decision No. 36,739 and the order therein contained the Railroad Commission has not regularly pursued its authority, has denied the petitioner due process of law, has taken its property and the use thereof without compensation, in violation of its rights under the Constitution of the State of California and the Fourteenth Amendment to the Constitution of the United States, and has acted arbitrarily and capriciously in that the order requiring petitioner to reduce its fare from 7 cents to 6 cents per passenger is not supported by the evidence, is contrary to the evidence, and will result in a reduction of petitioner's gross operating revenue to the point where it will have no net income at all, but will suffer a substantial deficit. In this regard petitioner alleges and shows as follows: [here follow detailed specifications]."

These federal questions were expressly passed upon by the Supreme Court of the State of California and the order of the Commission sustained as against its claimed invalidity under the due process clause of the Fourteenth Amendment.[8]

Statement of the Grounds Upon Which It is Contended the Questions Involved are Substantial:

1. The decision and order of the Railroad Commission directing appellant to reduce its rates was issued without any complaint first made or other form of notice given specifically charging appellant with the maintenance of unreasonable rates, without otherwise framing the issue of unreasonable rates by directing evidence and argument

[8] See Appendix 3 attached hereto.

to that issue, and without allowing appellant an opportunity to introduce evidence on this issue when it was first raised by the decision and order of the Commission.[9] The order, therefore, is invalid and deprives appellant of its property without due process of law, contrary to the Fourteenth Amendment.

Morgan v. *United States*, 304 U. S. 1, 14-22;
Ohio Bell Telephone Co. v. *P. U. Commission*, 301 U. S. 292, 300-306;
West Ohio Gas Co. v. *P. U. Commission*, 294 U. S. 63, 67-71.

The investigation instituted by the Commission was general in its scope. It was not a complaint of the kind required by section 60 of the California Public Utilities Act [10] setting forth something done or omitted to be done by petitioner. It was not followed by any more specific notice as to what the Commission proposed to do, notice either in the form of an order to show cause why certain action should not be taken or by the issuance of proposed findings and conclusions. Nor was the issue of unreasonable rates framed during the course of the hearings by the introduction of evidence directed concretely to that issue. On the contrary, the statements made by the Commissioners, and the evidence offered by Commission witnesses, indicated that the reasonableness of rates was not an issue.[11] It is not sufficient that the Commission's broad order of investigation merely mention the subject of rates along with other objects of inquiry. The issue of unreasonable rates must be more concretely framed than this (*Morgan* v. *U. S.*,

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[9] As was prayed in the petition for a rehearing filed with the Railroad Commission. See footnote 5, supra.

[10] See footnote 1, supra.

[11] See excerpts from the transcript, Exhibits E and F to Petition for Writ of Review.

supra). As the Supreme Court said in that case: "Those who are brought into contests with the government in a quasi-judicial proceeding aimed at the control of their activites are entitled to be fairly advised of what the government proposes and to be heard upon its proposals before it issues its final command."

2. The decision and order of the Railroad Commission directing appellant to reduce its rates was made without any or substantial evidence to support it, and is based upon assumed facts not in evidence. The order, therefore, is invalid and deprives appellant of its property without due process of law, contrary to the Fourteenth Amendment.

I. C. C. v. *Union Pacific Railway Co.*, 222 U. S. 541, 547;

I. C. C. v. *Louisville & Nashville Railway Co.*, 227 U. S. 88, 91;

Chicago Junction Case, 264 U. S. 258, 262-266;

U. S. v. *Abilene & Southern Railway*, 265 U. S. 274, 286-290;

West Ohio Gas Co. v. *P. U. Commission*, 294 U. S. 63, 69-70;

Ohio Bell Telephone Co. v. *P. U. Commission*, 301 U. S. 292, 302-304.

The proceeding before the Commission was not tried as a rate case. There was no competent evidence of the value of petitioner's property devoted to the public use, nor any evidence of what would constitute a fair return on that property, nor any evidence of the results which might be expected with the application of some fare below that being charged by petitioner.

Evidence is entirely absent concerning:

1. The amount of traffic moving under petitioner's present 7-cent fare in San Francisco.

2. The present revenue from that traffic.

3. The expense of handling that traffic.

4. The capital used in rendering this service.

5. An estimate of the traffic that would move if this rate were reduced as ordered.

6. An estimate of the revenue from that traffic.

7. An estimate of the expense of handling that traffic.

Items 1, 2, 3, and 4 are necessary to any determination that the existing 7-cent rate in San Francisco is unreasonable.

Items 5, 6 and 7 are necessary to any determination that the proposed new rate is reasonable.

Nevertheless, the Commission made assumptions without any basis in the evidence of results anticipated under various fare structures; and, likewise without any evidence thereon, it purported to measure the value or worth of the service being rendered and fix a rate on that basis. As was said in the *Ohio Bell Telephone Co.* case, supra, page 300, the Commission "without warning or hint of warning that the case would be considered or determined upon any other basis than the evidence submitted," proceeded to find reasonable and to fix a lower rate for the future without any evidence to support its action.

3. The decision and order of the Railroad Commission directing appellant to reduce its rates upon the erroneous theory that the rates presently charged are in excess of the value of the service being rendered is invalid and deprives appellant of its property without due process of law, contrary to the Fourteenth Amendment, in that,

(a) A utility is entitled to charge rates equal to the cost to it of rendering service, including a fair rate of return upon the fair value of the property used and useful in that service, and permitting the utility to maintain its financial integrity and to attract capital.

Prescribed rates yielding a lesser return are confiscatory.

Los Angeles Gas & Electric Co. v. *Railroad Commission*, 289 U. S. 287, 305;

Railroad Commission v. *Pacific Gas & Electric Co.*, 302 U. S. 388, 394-395;

Denver Union Stock Yard Co. v. *United States*, 304 U. S. 470, 475;

Natural Gas Pipeline Co. v. *Federal Power Commission*, 315 U. S. 575, 585;

Federal Power Com. v. *Hope Nat. Gas Co.*, 320 U. S. 591, 605.

(b) The value of the service theory, and the ability of consumers to pay for service, have been rejected as bases for the determination of reasonable rates.

Chicago Railways Co. v. *Illinois Commerce Commission*, 277 Fed. 970, 976-977;

Denver Union Stock Yard Co. v. *United States*, 57 F. (2d) 735, 740-741;

Telluride Power Company v. *P. U. Commission of Utah*, 8 F. Supp. 341, 343;

Mississippi River Fuel Co. v. *Federal Power Commission*, 121 F. (2d) 159, 164;

Puget Sound Power & Light Co. v. *Department of Public Works*, 38 P. (2d) 350, 351-353, 179 Wash. 461;

Duluth State Railway v. *Railroad Commission*, 152 N. W. 887, 892-893, 161 Wis. 245;

Wisconsin-Minnesota Light & Power Co. v. *P. U. Commission*, 197 N. W. 359, 362, 183 Wis. 96;

Miller v. *Railroad Commission*, 9, Cal. (2d) 190, 201.

4. The decision and order of the Railroad Commission directing appellant to reduce its rates is confiscatory in that it will not permit a fair return upon the value of appellant's property devoted to the public use. As the Commission itself points out,[12] the only "indication" in the

[12] See footnote 19 in the Opinion of the Railroad Commission, Exhibit I hereto.

record of what might be the fair value of appellant's property is a resolution of appellant's board of directors, passed March 25, 1943, authorizing the sale of appellant's operative properties to the City and County of San Francisco for $7,950,000. If, as both the Commission and the Court below assume, appellant had "offered" its property to the City at this figure, the offer would not support a finding of value for rate-making purposes.

> "For the purpose of public regulation market value can have absolutely no application. * * * What the thing will sell for, of course, is largely determined in the market by its earning power. The earning power of a utility is determined by its rates."[13]

In fact, however, there was no "offer." The record shows that there were abortive negotiations, tentative on each side, never approved on the City's part by a vote of the people, or on appellant's part by a vote of its shareholders.[14] Beyond this, the resolution itself gives no basis for assuming that the price named had any relation to the value of petitioner's property.[15] It simply states that the price was considered "the best price obtainable" from the City under all the circumstances, which included acceptance at an election by the voters of the City.

But even if it be assumed that appellant's rate base is $7,950,000, the order is still confiscatory. Obvious corrections of the Commission's own assumed figures of revenue

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[13] John M. Eschleman (draftsman of the California Public Utilities Act and first President of the California Railroad Commission), "Control of Public Utilities," 2 Cal. L. Rev. 104, 112.

[14] City Exhibits Nos. 8, 9; petitioner's Exhibit G.

[15] The book value of appellant's road and equipment on December 1, 1942, was $41,768,505; capital invested at the end of 1942 was $36,214,425.68; the last historical cost valuation of appellant's property by the Commission, made in 1920, showed historical cost, undepreciated, of $29,715,147. See concurring opinion of Commissioner Sachse, Exhibit 1 attached hereto; Comm. Exhibit No. 2, sheet 2, notes 2 and 3.

and expense show that appellant will operate at a net loss under the 6-cent fare. There is, therefore, no justification for any reduction, regardless of the rate base assumed.

Conclusion

We respectfully submit that this Court has jurisdiction of the appeal.

Dated: July 31, 1944.

Respectfully submitted,

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FELIX T. SMITH,
FRANCIS R. KIRKHAM,
HENRY G. HAYES,
Counsel for Appellant.

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Of Counsel.

EXHIBIT 1

Before the
Railroad Commission of the State of California

Decision No. 36,739

In the Matter of the Investigation upon the Commission's own motion into the reasonableness of the rates and charges, and into the sufficiency and adequacy of the operations, service, and facilities of the Market Street Railway Company.

Case No. 4680

Cyril Appel, Ivores R. Danes, and Samuel Kahn, for the Market Street Railway Company.

Angelo J. Rossi, Mayor, John J. O'Toole, City Attorney, Dion R. Holm, Assistant City Attorney, and Paul Beck, for the City of San Francisco.

Mrs. Helen Negrin, in *propria persona:*

By the Commission:

Opinion

In April of this year we came to the conclusion that the public interest demanded an inquiry into the local transportation situation in San Francisco, in so far as the matter is within our jurisdiction, and ordered an investigation into the rates, charges, classifications, rules, and regulations of Market Street Railway Company (hereinafter sometimes referred to as the company), and also into the reasonableness, sufficiency, and adequacy of its operations, service, and facilities.

Hearings before the Commission en banc were held in San Francisco on May 10, July 15, and September 15, 1943. Our staff made its studies and investigation in part prior to the

hearing of May 10, and in part during the course of the proceeding, and introduced the results in the form of 18 exhibits.[16] The company put 14 exhibits in evidence,[17] and the City of San Francisco one.[18] Upon the completion of testimony on September 15, 1943, the case was taken under submission and is now ready for decision.

Background of Present Proceeding

The issues in this case can be better understood after a brief review of the company's history, particularly its recent history since 1937, and the previous rate decisions of this Commission.[19]

Public transportation in San Francisco goes back to 1852 when an omnibus service began to operate over a few of the city's streets. In 1860 the first street railway, the Market Street-Mission Dolores line, was opened for service. In 1873 the first cable line was put into operation and later expanded. This form of mass transportation met with such success that during the next ten years a number of horsecar lines were converted to cable lines. Electric street railway service came to San Francisco in 1891. The Market Street Railway Company was incorporated in October 1893 and took over 11 of the 17 streetcar lines then independently operated in San Francisco. Additional properties were later acquired by that company.

The 1900 San Francisco city charter declared in favor of municipal ownership of public utilities and provided that franchises could be granted to privately-owned street railway companies for a period not to exceed 25 years, at the end of which time all tracks and overhead construction were to revert to the city at no cost.

United Railroads of San Francisco was incorporated in 1902, taking over the properties of its predecessor

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[16] Exhibits Nos. 1 to 6, incl.; 8 to 17, incl.; and No. 33.

[17] Exhibits Nos. 19 to 32, incl.

[18] Exhibit No. 7.

[19] Decision No. 29889—40 CRC 525 (6-21-37)
Decision No. 30849—41 CRC 349 (5-9-38)
Decision No. 31472—41 CRC 651 (11-23-38)

Market Street Railway Company and five other lines, and bringing together under one control 229 miles of track, a large portion of which was cable operated. This system suffered heavily in the earthquake and fire of 1906, and a considerable reconstruction program was carried out between 1906 and 1910, with some replacement of damaged cable lines by overhead electric traction lines.

In December 1912, the City and County of San Francisco placed in operation a street railway line on Geary Street from Kearny Street to 33rd Avenue. It replaced the old Geary Street cable line. During the next few years the Municipal system, which is not under the Commission's jurisdiction, expanded rapidly through the construction of lines to serve Panama Pacific Exposition in 1915.

Because of its failure to pay interest on its outstanding 4% bonds, United Railroads of San Francisco properties were sold at a foreclosure sale. They were acquired by representatives of the bond holders who transferred them on or about April 1, 1921 to Market Street Railway Company, the company now before us. In 1925 the Standard Power and Light Corporation acquired about a 40% stock interest in and virtual control of Market Street Railway Company.

Prior to 1930 a number of the company's franchises expired. Certain lines were operated under sufferance by the city pending clarification of the franchise situation. In November, 1930, the voters of San Francisco adopted and subsequently the State Legislature ratified a charter amendment permitting the company to surrender its remaining franchises to the city and county in exchange for a 25-year operating permit. This permit apparently annulled the 1900 city charter provision requiring the reversion, without cost to the city, of property covered by 25-year franchises; the city, at any rate, did not enforce such charter provision. The 1930 permit provides that the city may acquire the company's properties at a fair price during the life of the permit.

Under ordinance of the City and County of San Francisco one-man streetcar operation was prohibited. In 1933 the company sought repeal of this ordinance. The

petition was denied by the city authorities but the company succeeded in 1934 in obtaining a temporary injunction against the enforcement of the ordinance. The city appealed and the one-man car issue was carried to the U. S. Supreme Court, with the result that the city's two-man car ordinance was upheld. The company had, prior to the final determination of the lawsuit, commenced one-man operation on a number of its lines and continued such operation in greater or less degree until February 1939.

The first bus or motor coach line was operated in 1925 and at the end of 1938 the company had 11 motor coaches in operation. From 1939 forward some further change-over from electric and cable car operation to motor coach service took place and 125 coaches were in service on December 31, 1942. Two cable lines remain in operation on the company's system at the present time.

The expansion of the Municipal Railway system since 1912 became an increasingly serious competitive factor in the operations and finances of the company. Agitation for acquisition of the company's system by the city commenced in 1912 and has continund more or less actively to the present time. The question of purchase through the medium of tax lien bonds, or railway revenue bonds, has been submitted to the voters on a number of occasions and been rejected every time. The most recent elections were held in November 1942 and in April 1943.

Most of the company's original franchises contained a five-cent fare clause. The five-cent fare, with transfer privileges, continued uninterruptedly on both the company's and the Municipal lines until July 6, 1937. On that date the first fare increase, granted by this Commission, became effective on the company's system, but the five-cent fare remained unchanged on the city-owned lines.

In 1937 the company applied to the Commission for a rate increase to a seven-cent cash fare. In decision No. 29,889 this application was denied but a two-cent transfer charge and an increase from 20 to 25 cents for a Sunday and holiday pass was granted. In March 1938 the com-

pany again petitioned for an increase to a seven-cent cash fare, with reduced rates to school children. In supplemental decision No. 30,849 the Commission authorized a seven-cent cash fare, with four tokens for 25 cents on other than interurban cars, 16 rides for 50 cents to school children, and an increased fare on interurban lines. A few months later, in a second supplemental application, the company again petitioned for a straight seven-cent fare and asked for authority to discontinue the token rate. In decision No. 31,472 of November 23, 1938, the Commission directed the company to petition the city for authority to abandon operation of certain lines and for relief from "Jitney" competition. The decision authorized the rate increases sought by the company in the event that such authority and relief were not granted by the city on or prior to January 1, 1939. The seven-cent fare became effective on that date and has remained in effect to the present time.[20]

The operating and financial results of this fare change will be referred to later in some detail. Here it is sufficient to say that both traffic and revenue continued to decline and in 1941 reached their lowest point in twenty years.[21] The operating income, after operating expenses,

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[20] The fares at present in effect are as follows:

7-cent cash fare in San Francisco, other than on interurban cars, with free transfer;

School children 16 rides for 50 cents, with free transfer;

Sunday and holiday pass, for use in San Francisco, 25 cents;

South San Francisco line, 7 cents;

San Mateo line, 7 cents, fare to be in accordance with the tariff filed with the Railroad Commission on May 23, 1938.

[21] Comparing 1941 with 1936, the last full year under the five-cent fare:

Year	Revenue Passengers	Index	Passenger Revenue	Index
1936	153,911,000	100%	$7,437,039	100%
1941	89,855,000	58	6,010,757	81
Loss	64,056,000	42	1,426,282	19

depreciation, and taxes, dropped from $783,486 in 1936 to $210,345 in 1941, a decline of 73 per cent. In 1942 and 1943 the consequences of the war, together with other causes, brought about an abnormal increase in traffic, increased revenues and expenses; a further marked deterioration in the service to the public, and other difficulties, all before us in this proceeding.

Service

The principal issue at this time is the adequacy of the service the company is furnishing the pubilc and the character and quality of such service in relation to the rates the public must pay. Operating revenues, operating expenses, operating income (net operating revenue), property value and rate base and rate of return also have their place in this case, but the significance of these items is *lost unless past, present and prospective* operating and service conditions are kept in mind.

The record shows that service has progressively deteriorated for a number of years, notwithstanding the total 40 per cent rate increase in 1937 and 1938, and is rapidly growing worse under war conditions. We recognize that some of the causes of the present unsatisfactory service are beyond the company's control and cannot justly be charged against this utility's management. All transportation agencies and other utilities, and indeed the entire economy of the country, are laboring under the stress and impact and the difficulties of the world war. Full allowance will be made for this fact in all wartime proceedings before the Commission.

After making such allowance the important question remains to what extent the ratepayer, under war conditions, should be compelled to pay the same or higher rates for an inadequate and inferior product or service while the utility enjoys abnormal profits.

In this case there is evidence, moreover, of long-time neglect, of mismanagement, of indifference to urgent public need, and of other matters inevitably productive of poor service that by no means were caused by or can be charged to the war, and for the consequences of such failure

the company must assume responsibility. The record is voluminous on these points and reference can be made only to the more important and outstanding causes of the unsatisfactory and insufficient service.

Accepted and acknowledged standards exist for measuring the quality and adequacy of mass transportation service in large cities. Mr. Kahn, the company's president, testified that his company does not use or apply any such standards in San Francisco, and the city authorities, under their police power, have not enforced such standards. Mr. Hunter, the Commission's chief engineer, testified that "for normal times" the service is unreasonably bad.[22]

Aside from general standards, based on vehicle seating capacity and percentage of passengers who cannot be seated, a more specific and direct test of the quality of service can be had through an analysis of the company's operating schedules, performance records, track and equipment maintenance condition, manpower and employment situation, status of operating supervision, condition of street cars and buses, and the company's depreciation and renewal practices. Comparison can then be had of the company's present showing and its showing in prior years, and of this company's record in these respects with the record of its competitor, the Municipal Railway, which charges a five-cent fare. The company's seven-cent fare, it will be noted, is 40 per cent higher than that of the Municipal railway.

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[22] "COMMISSIONER CLARK: May I ask, to your knowledge, has the Railroad Commission, through its staff, made any check to determine to what extent the standard that you refer to is being complied with or violated? A. In Los Angles or here?

Q. Here in San Francisco? A. Well, first the rule is not in effect here, but our studies show that it is not being complied with by quite a wide margin now.

Q. Have you any facts or figures to indicate whether or not, conditions as they are now being experienced by those who are dependent upon street cars are entirely unreasonable in that respect? A. Normal times, I would say 'yes' they are unreasonable in normal times. But, of course, war times you have to put up with things that you just cannot better. But for normal times I would say that this service is unreasonably bad."

Mr. Kahn testified that during normal times the number of *car hours operated* should and would fluctuate in an approximately direct proportion to the number of passengers hauled.[23] Exhibit 22, introduced by Mr. Kahn, is based on that assumption. The record developed, however, that the bases used in Exhibit 22 was "entirely theoretical" and in no sense reflected the company's actual operating practice either in "normal" or in "abnormal" times.

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[23] "COMMISSIONER CLARK: Is it your contention as a transportation engineer that during normal times, during the period which this prophecy was made, this projection was made, that if you had 19½ per cent increase in passengers that wanted to ride that you mean that your average car hours would be 19½ per cent increase also? A. I should think that would generally be—at least it may not follow precisely, but the trend would be that way.

Q. If your opinion was asked as a traffic engineer, traffic engineer counseling with the company, would it be your statement in your best judgment if you had a 19½ per cent increase in traffic, whatever the cause might be, that they should make provision for 19½ per cent increase in car hours? A. Yes, I can only repeat if the trend was developed, why, the company would have to provide for more service. Now, as to whether 19 per cent increase in car hours would precisely equal the 19 per cent in increased traffic I am not prepared to say that would be the exact percentage, but it would approximate that percentage.

Q. In your engineering recommendation, based on experience, can you tell me a single instance in your years of experience or observation that such a condition has resulted? A. Well, I think it results in practically every street car company as the patronage is increased is obliged to add to its service.

Q. That is a general statement, that is not an answer to my question. The question really gets down to engineering, if you have a 19½ per cent increase do you think it is reasonable to assume that you would have to have a 19½ per cent increase in car hours to handle that induced traffic? You would—don't you agree that you would have an improved load factor likely resulting from that increase? A. Improved load factor?

Q. If along a given right of way you had a 19 per cent improvement in travel conditions, that is, as far as those who wanted to ride, or an increase of 19½ per cent in load, don't you believe you would have an improved load factor on that particular phase of the transit system? A. In normal times?

Q. In any time? A. In normal times I think the increase would be spread over the day following the same pattern as the normal pattern; in abnormal times I do not think any of those rules hold."

With reference to *operating schedules*, Mr. Hunter testified:

> "Based upon the foregoing premises our study supports the conclusion that the service on the Market Street Railway should be improved. This conclusion is based upon the record in that the available street cars and buses are, in many instances and particularly during times of peak travel, overcrowded and the service is irregular. The overcrowded condition is accentuated by the equipment not being operated on schedule.
>
> "Our traffic check, as presented by Mr. Hall, shows the cars and buses often operate with an irregular spacing. In other words, there will be long intervals between cars and buses followed by grouping of units. In some cases it may be noted that units are actually operated ahead of schedule."

And further:

> "Table No. 1 of Exhibit No. 11 shows that during the year ending April 30, 1943, the percentage of motor coaches and street cars which failed to operate in accordance with the schedule requirements steadily from 0 to 5.7 per cent. In comparing this record with that of the Los Angeles Railway and Municipal system we find the Municipal operation meets its schedule with few exceptions while the Los Angeles Railway's failures increased from 0.8 per cent to 4.5 per cent. The better record of the Municipal system as compared to that of the Market Street Railway may be explained in part, at least, by the fact that the rate of pay is slightly higher and other attractive labor benefits as shown on Table VII of Exhibit No. 11."

Mr. Hall, transportation engineer of the Commission, testified that in March 1943 an average of 16 cars were out of service daily and 69 trips were lost per day. Car and coach schedules not performed increased from 0.2 per cent in September 1942 to 10.3 per cent in June 1943, while for the Municipal Railway during the same period

such non-performance never amounted to more than 0.1 per cent. The unfilled schedules on Los Angeles Railway, in comparison, amounted to 4.5 per cent in April 1943.

With reference to *operating performance* as reflected in traffic and loading records, the Commission's Transportation Department made traffic checks on April 29 and 30, 1943 (Exh. 6), and found that on the latter two days at the points checked, on inbound morning trips 17,516 seats were available for 25,675 passengers, while on the outbound afternoon trips 20,119 seats were available for 31,399 passengers. These figures represent load factors of 1.5 and 1.6, respectively, and show that for each one hundred seated passengers 50 passengers had standing room only during the morning inbound traffic check period, while 60 had standing room only during the evening outbound period.[24] Exhibit 6 also shows that on December 9 and 10, 1942, when similar checks were made, substantially the same overload conditions existed. This overloading is aggravated by the fact that many of the company's cars operate ahead of schedule, while in many cases groups of cars travel together, followed by rather long intervals of no cars.

One serious cause of unsatisfactory service for which the company is directly responsible is lack of proper supervision and inspection. Mr. Hunter, in Exhibit 17, recommends:

> "Market Street Railway should provide better service by improved field supervision, so that when cars or buses get off schedule and operate in close proximity with the resulting long intervals between units, some of them should be turned back even at the expense of discommoding some passengers in the interest of better overall service on the system."

The same exhibit shows that the salaries of this company's inspectors are low in comparison with those of Municipal Railway, Key System, and Los Angeles Rail-

[24] Morning inbound check period 6:40 to 8:59 a. m.
Evening outbound check period 4:00 to 6:39 p. m.

way.[25] The company is now making efforts to improve this condition.

For a long period of time the company has had a large number of cars (at present approximately 70) available for operation and badly needed to furnish better service, standing idle in storage and out of operation because of alleged manpower shortage. This does not include the cars held out of scheduled operations for lack of operators. Mr. Hall testified that if this idle equipment were put to use it would materially improve the service on heavily loaded lines during peak periods.

The record is voluminous with reference to the deplorable condition of track, of deferred maintenance, unfulfilled street paving obligations, obsolescence of streetcar equipment, and the failure of the company to replace, during prewar years, uneconomical and outdated facilities by modern, more efficient, and more profitable means of mass transportation.

Preliminary inspection of the company's tracks, Mr. Hall testified, showed much deferred maintenance over the entire system and that, while under moderate speeds operation is reasonably safe, it is imperative that the deferred maintenance be caught up with at the earliest possible date. The poor condition of track has not developed during the war period, when valid excuses because of manpower and material shortage can be made, but represents a condition that has progressively grown worse over a long period of years. This is clearly indicated by the fact that during the last 15 years, from 1928 to 1942, there has been a marked and almost continuous reduction in the annual operating expenditures for way and structures, including track and paving and distribution system, and notwithstanding the further fact that the operative property represented by the company's way and structures account is substantially the same in

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[25] Field inspectors rate of pay (per month)—Los Angeles Railway, 8 to 9 hours per day, $215, plus 1½ for overtime over 9 hours; Key System, 8-hour day, $210 to $225; Municipal Railway, 8-hour day, $200 to $240; Market Street Railwy, 8-hour day, $180.

amount in 1942 as it was in 1928.[26] The footnote below indicates that in 1941 and 1942 only 37 per cent was spent each year for way and structures maintenance, compared with the amount represented by 100 per cent in 1928, and that while in 1928 this expenditure represented 8.47 per cent of the total operating cost, in 1942 only 4.36 per cent of total operating costs was represented by such maintenance. The footnote also shows that even in the prewar year of 1940 these maintenance expenditures were only half of the 1928 amount and represented only 6.5 per cent of total operating expenses.

Mr. Kahn was asked whether he was making, or was contemplating, any financial provision for deferred maintenance. His answer was:

> "We have no definite program of setting aside anything for maintenance. We think our first obligation is to discharge our debts, it was money honestly borrowed and we want to honestly repay it. Having

[26] Table 4-2 of Exhibit 10 shows the company's operating expenses, Group 1—Way and Structures, accounts 501 to 529, incl., for the period 1928 to 1942, both inclusive, as follows:

Year	Amount	Index (1928=100)	Cost per Car-Mile $	Cost per Car-Hour $	Cost per Mile of Track	Per Cent of Total Operating Expense
1928	$656,462.25	100%	2.48¢	22.3¢	$2,315	8.47%
1929	574,991.78	88	2.21	20.2	2,043	7.70
1930	548,853.89	84	2.16	19.8	1,964	7.53
1931	476,423.26	73	1.96	18.2	1,704	6.94
1932	483,094.12	74	2.04	19.4	1,695	7.39
1933	474,124.23	72	2.08	20.1	1,664	7.98
1934	473,671.33	72	2.16	20.9	1,657	7.97
1935	424,710.27	65	1.94	20.0	1,554	7.20
1936	482,469.19	73	2.37	22.3	1,793	8.15
1937	451,172.76	69	2.31	21.4	1,695	7.55
1938	430,533.07	66	2.41	22.4	1,621	7.71
1939	349,941.90	53	2.17	20.5	1,376	6.64
1940	329,329.54*	50	2.38	22.5	1,307	6.50
1941	245,657.54*	37	2.05	19.2	1,051	4.98
1942	243,099.18*	37	2.06	18.9	1,107	4.36

* Includes minor amounts for motor coach operations in Account 24-1, Carhouses, as follows:

1940	$1,759
1941	2,832
1942	1,332

$ Rail and trolley coach.

gotten our debts out of the way we feel that we will then be in shape to refinance when the war is over or perhaps sooner so that we can improve our service generally, and when I say 'improve,' I mean improve in the broadest sense. That covers both modernization and improvement of present facilities."

We cannot agree with this concept of the obligations of the company, as expressed by its president, toward its patrons. We appreciate that a utility must pay its indebtedness if the stockholders desire to remain in control of the properties. The stockholders and not the ratepayer authorized the creation of the indebtedness and he is primarily responsible for its payment. Money allowed in rate proceedings for operating expenses should not be devoted to the payment of indebtedness. The company cannot expect, and this Commission has never held, that the ratepayers, in addition to paying for the cost of service, must provide the money to pay indebtedness. In our opinion, the first obligation of the company is to use its income to pay the cost of a reasonable, adequate and satisfactory service to the public. Necessary and legitimate operating costs have priority over all other expenditures. If the stockholders are unable, or, because of past losses, unwilling to advance funds to the company to pay its indebtedness, they should turn the properties over to the company's creditors. An analysis of the company's finances shows that over a period of years the company has used funds urgently required for proper maintenance, and for the replacement of depreciated property, for the payment of indebtedness.

The City of San Francisco, through Mr. Vensano, Director of the Department of Public Works, introduced Exhibit 7[27] containing a study and analyses of the obligations of the company in so far as they relate to the physical conditions of the streets occupied by the Market

[27] Exhibit 7 is entitled "Report of the Obligations as to the Use of Streets and Condition of Streets Used by the Market Street Railway Company (In Accordance with Ordnance 1892 (Series of 1939) Passed by the Board of Supervisors and Approved December 15, 1942)," dated June 30, 1943.

Street Railway. This exhibit indicates that the company's total obligations for bringing *street paving* into proper condition, as required by franchise obligations, amount to $1,691,162.76. Mr. Vensano testified that this amount does not include any track reconstruction, except the minimum cost of raising the rail to a uniform grade line where that is necessary and, further, that this deferred paving maintenance has accumulated over many years.

The company's *streetcar rolling stock* is obsolete and 73 electric cars and 12 cable cars were out of service on May 1, 1943. Of the total number of 440 streetcars and 39 cable cars classed as operative by the company on May 1, 1943, the latest purchases were made in 1935 and 1936. In those years several second-hand one-man cars were acquired, which are now classed as "out of service." The balance of the operative streetcar equipment was built in the period from 1903 to 1933.[28] The 39 operative cable cars (12 of which are shown as "out of service") appear to have been built, or rebuilt, according to Exhibit 3, in the period from 1893 to 1907. A total number of 123 motor coaches were in service on May 1, 1943, all except one of which were purchased in the period from 1937 to 1942. (49 of these coaches are 1941 and 1942 models). It will be noted that more than two-thirds of the electric streetcars in service are 20 or more years old and that no streetcars have been purchased by the

[28] Exhibit 3 shows the age of streetcars as follows:

Number of Electric Streetcars	Built in	Remarks
18	1903	Rebuilt in 1922
9	1907	
144	1911	Two of these "out of service"
20	1913	
2	1918	Bought second-hand in 1935; now classed as "out of service"
148	1923-1930	59 shown as "out of service"
20	1924-1925	
10	1927	Bought second-hand in 1936; all 10 shown as "out of service"
69	1931-1933	

The company also operates 9 electric trolley coaches purchased in 1935 and 1936.

company since 1936. In that period great progress has been made in modernizing and increasing the operating efficiency of electric streetcars. The company has not participated in this progress.

Mr. Hall testified that there is considerable deferred maintenance on streetcars now in active service.

Referring to the *idle equipment* owned by the company and which, because of the alleged manpower shortage, cannot be put into service on the company's lines, it developed that the Municipal Railway through the city's Public Utilities Commission, has offered to lease from the company as many cars as can be spared, such cars to be operated on the Municipal lines.[29] The company has declined to make any such lease. Mr. Cahill, manager of the Public Utilities of San Francisco, testified that the city has been refused priorities for the purchase of motor coaches time after time, by the Office of Defense Transportation in Washington, D. C., for the reason "that we are not utilizing here in San Francisco all the rolling stock which exists; that is true as to streetcars only." The Municipal Railway, Mr. Cahill testified, does not store and has not available any idle streetcar equipment.

No satisfactory reason has been given the Commission why the large number of idle streetcars owned and classed as operative by the company is not put to much needed use during this critical war period. The excuse of manpower shortage is not convincing. If the Market Street Railway cannot use these cars, the Municipal Railway apparently can and has declared its willingness to pay a fair rental. Such rental payment would increase the company's net revenue and, what is more important, would provide urgently needed additional transportation for the people of San Francisco. We are compelled to

[29] From letter of Public Utilities Commission of San Francisco to Office of Defense Transportation, San Francisco: "The Public Utilities Commission of San Francisco also desires to lease on a rental basis as many of the Market Street Railway Cars as that Railway can spare, these cars to be used anywhere on the Municipal Railway that the Public Utilities Commission thinks fit."

conclude that the primary, if not the only, reason why no use is being made of this equipment is found in the competitive situation and because some traffic might be diverted from the Market Street lines to the Municipal lines, although there is nothing in the record indicating that such diversion would occur.

Manpower Shortage

The matter of manpower shortage occupies an important place in this proceeding. Mr. Kahn said: "Generally speaking our difficulty at this time is not one of equipment, it is one of manpower * * *." We are aware that manpower shortage is now a nation-wide difficulty, aggravated on the Pacific Coast, and not confined to this company or to transportation companies and other utilities. We note, however, a marked difference in the manpower situation as between different operators and utilities and in its effect on the essential public service rendered by such different operators. These differences compel the conclusion that company and management policies affecting employee relations, wages and salaries, working conditions and attitude toward the public in general have a large effect on manpower shortage. The more enlightened and liberal such policies have been in the past, and the more sincerely they are continued in actual performance during this period of crisis, the more readily the manpower problem can be dealt with, to the advantage of the war effort, the public service, and the utility.

Careful studies into this subject were made by our staff and by the company and exhibits 10, 11, 17 and 26 deal wholly or partly with this matter. This evidence may be summarized. In April 1943 the platform men shortage, measured against the force required for scheduled services, was 18 per cent on the company's operations; on the Municipal Railway the shortage was 9 per cent; on the Los Angeles Railway 13 per cent. By June of this year Market Street's shortage had increased to 22 per cent, while Municipal's had dropped to 6 per cent. The company sustained a net loss (reflecting all labor turnover) of 13 platform employees in the 14 months

ending June 1943, while Municipal gained 143 such employees. It is obvious that those figures, by themselves, account for a large part of the difference between the relatively poor service of Market Street Railway and the relatively good service of the Municipal system.

The record indicates the reasons for the much more severe manpower situation on the company's lines compared with Municipal's. The causes are found partly in the somewhat higher wages paid Municipal employees, the fact that they have a large measure of employment security through Civil Service, they receive sick benefits, the working conditions are generally better than on the company's operations, and the equipment and plant they operate are better and safer.

Mr. Newton, the company's vice president, testified that the company's working conditions are in some respects more favorable than Municipal's. Company employees work under Union agreement, have the "check off," received pay for waiting time, and enjoy low-cost medical protection. These advantages are not sufficient, apparently, to overcome the company's pronounced manpower shortage. To our inquiry as to what is being done and what might be done to mitigate the men and women shortage, the company, among other things, urged the suspension of the San Francisco one-man car ordinance for the duration, with the proviso that proper care would be exercised in selecting the lines suitable for one-man operation. Mr. Kahn testified that such suspension would relieve the company's platform labor shortage to a great extent. In view of the determination of this issue by the City's electorate and by the courts we see no prospect of relief through this means in the direction of better transportation service for the City of San Francisco.

No complaint can be made in regard to the company's service to establishments directly serving the war effort, such as shipyards and other war industries, and to Army and Navy concentration points. A letter of commendation from the Office of Defense Transportation is in evidence. Lieut. Commander Jenkins, U. S. N. R., Domestic Transportation Office, 12th Naval District (former trans-

portation research engineer of this Commission), testified that the company's service to Naval establishments has been satisfactory and that there has been co-operation with Navy headquarters. He stated that the Navy's transportation service requirements will greatly increase in the near future.

We wish to put on record our conviction that all service requirements in furtherance of the war effort must have primary consideration of this company, as of all other utilities under our jurisdiction. Within the limits of our authority we are making, and shall continue to make, every effort to co-operate with the Army and Navy and with the appropriate federal agencies towards that end.

As to the character and condition of the present service generally Mr. Hunter, chief engineer of the Transportation Department, testified as follows:

> "I next refer to the matter of the value of the service. Although this study and investigation does not analyze the rate s.. ation I do not think we can entirely close our eyes to the value of the service. Obviously, they should be in balance as near as can be at all times and with the service getting worse, I will say on the Market Street, or at a low stage there is no question but what the passengers are getting less for their money today than they were when they got better transportation. But I think the important thing today is to get transportation of any kind. I think the public is willing to pay if you will give them some service. If you desire to go from the station to your office up town, 3rd and Townsend, say, the public is willing to stand, but they would like an opportunity to get any kind of service. But, nevertheless, they are getting less for their money, much less than in normal times, and I think we have to think of that." [30]

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[30] "Commissioner Sachse: On the question of service, Mr. Hunter, in your opinion, is the service now rendered by Market Street Railway in San Francisco worse or of approximately the same quality and character of service as it was during the 5-cent fare era prior to the war emergency?

"A. I think the service is worse now.

The inseparable *relationship between rates and service* and the interdependence of the character and quality of utility service on the one hand and the level of the rates on the other hand have long been recognized by regulating commissions and by the courts. This Commission in Decision No. 2483 (1915), *W. J. Rogers, et al. v. Sacramento Valley West Side Canal Company, et al.* (7 CRC 145), said:

> "Another element which must be taken into account in establishing the rates in this case is the ability of the consumer to pay. It is a well-established principle of public utility regulation that whatever rates might be secured from the application of the usual principles of valuation, a public utility can in no event charge a rate which is beyond the reasonable ability of its consumers to pay. *The rates must be reasonable to the utility, but they must, in any event, be reasonable to the public.* (Emphasis supplied.)
> "In *Covington & L. Turnpike Road Co. v. Sanford*, 164 U. S. 578, the Supreme Court of the United States was considering the reasonableness of maximum rates

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"Q. In your opinion should the cost of the service that the public is to pay, must pay, have some relation to the quality of service that is rendered, in so far as the public is helpless, beyond its control to get better service for the same amount of money that they pay? A. Yes, that is covered in my recommendation No. 6.

"Q. Will you enlarge a little bit on that? That No. 6, reads as follows: 'The value of the service should be in keeping with the rates.'

"And I would like to have you keep in mind my thought on that so that you can give your answer with that in mind. Assuming that it is beyond the control of the Company to give as good service as it did some time ago do you think that, even under those circumstances, the public should pay the same or more than they formerly paid for a superior quality of goods of service, other things being equal?

"A. I think the service should go along with the rate.

"Commissioner Havenner: Do you mean by that when the standard of service decreases rates should be commensurately decreased, if that can be calculated? A. Of course, the service is only one feature in considering a proper rate; you must take into consideration all the elements, that is just one. But, obviously, as the service declines that should be recognized in establishing any rate, but to determine just what a rate should be on a particular service, you could not do it without considering all the other elements that go in. There are many."

to be charged by the Covington & Lexington Turnpike Road, as established by the General Assembly of Kentucky. At page 596, Justice Harlan says:

> 'The public can not properly be subjected to unreasonable rates in order simply that stockholders may earn dividends.'

"Again, on the same page:

> 'If a corporation can not maintain such a highway and earn dividends for stockholders, it is a misfortune for it and them which the constitution does not require to be remedied by imposing unjust burdens upon the public.'

"In the leading case of *Smythe v. Ames*, 169 U. S. 464, the same learned justice, at page 574, says:

> 'What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.'

"These cases clearly establish the principle that the rates to be charged by a public utility must in no event be higher than the service is reasonably worth to the public. It is unnecessary for me to point out that they do not hold that the utility can charge up to the maximum of what the consumer can pay."

In the case referred to the water company sought rehearing, contending that rates should be established which would yield operating and maintenance expenses, depreciation allowance, and a full return on fair value. In denying rehearing the Commission stated in part as follows (8 CRC 279):

> "While it is true that a rate fixing authority must consider all the matter to which petitioners refer, peti-

tioners overlook another principle which is equally well established, namely, that the public is entitled to demand that no more be exacted from it for a public service than the service rendered is reasonably worth. In other words, a rate fixing authority can not look solely to the position of the utility. It must look also to the position of the present and prospective consumers of the utility. See *Covington and L. Turnpike Road Co. v. Sanford*, 164 U. S. 578, and *Symthe v. Ames*, 169 U. S. 464, 547."

In *Lake Hemet Water Co.* (11 CRC 617, 638), this Commission says:

"Petitioner's refusal to claim rates high enough to yield a return on the estimated reproduction cost new of its property or any return on so-called intangible items over and above the value of physical property is based on a frank recognition of the well-established rule in public utility regulation that while rates must be reasonable to the utility they must, in any event, be reasonable to the public. The cases clearly establish the principle that the rates charged by a public utility must in no event be higher than the service is reasonably worth to the consumer." Citing *Covington & L. Turnpike Road Co. v. Sanford*, 164 U. S. 578, 596; *Smythe v. Ames*, 169 U. S. 464, 547; *San Diego L. & T. Co. v. Jasper*, 189 U. S. 439, 446; *Wilcox v. Consolidated Gas Co.*, 212 U. S. 19, 52; *Minnesota Rate Case*, 230 U. S. 352, 454.

The *Hemet* decision then continues as follows:

"The rates established may not be unjust from the point of view of the consumer. When it has been determined that rates beyond a certain amount would be unfair to the consumer, the value of the property for rate making can not be greater than the value which, at rates of interest sufficient to bring capital

into the business, will yield the revenue resulting from the rates established. This value may be very far indeed from the estimated cost of reproducing the property new. *Sacramento Valley Realty Company v. Sacramento Valley West Side Canal Company* (7 CRC 113)."

In Decision No. 12,761, *Coast Valleys G. & E. Co.* (24 CRC 53), this Commission said:

"The question of whether given rates are or are not reasonable depends as much upon the character of service supplied as upon the price which the consumer must pay for it. When service supplied by a utility is all that it should be, the conditions under which that service is extended to the community are liberal and the rates charged are found to produce more than a reasonable income, those rates should clearly be reduced.

"On the other hand if the service to the community in the broad sense is capable of distinct improvement, it would seem more desirable to reduce any excessive net revenue by increasing the quality of service rather than by decreasing the price paid for it."

The *Coast Valleys* decision then states as follows:

"In the present case, the company appears to be making every effort to give good service that is consistent with its financial ability. We believe, however, that the service is capable of improvement and should be extended to new consumers and to unserved portions of the territory covered under a much more liberal policy than that now followed. The schedule of rates embodied in the order accompanying this opinion will, therefore, not result in the extreme reduction which might be justified, but the company will be expected to continue the improvement of its system and to initiate a more liberal policy in the construction of line extensions."

All standard reference books on public utilities and commission regulation make note of the necessary relation between service and rates.[31]

The legal basis for the rule that fair and reasonable rates and fair and reasonable service must go hand in hand, and that conditions affecting one must affect the other, is well stated in the book referred to in the footnote below.[32]

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[31] From *Public Utility Economics by Thompson and Smith, New York* (1941), page 257:

"A review of the common law duties of public service companies discloses that historically the significant problems were two—rates and service, with the major emphasis on service. The years of regulatory effort in the United States have reversed this emphasis, at least from a publicity viewpoint. Today a phase of the rate problem—valuation—stands out in the public eye as the number one problem of regulation. This reversal is to be accounted for by the unsettled state of the valuation question. The public hears much about the 'breakdown of commission regulation' because of the impasse on that problem. One hears but little, however, about that other original primary problem—adequate service—because there is nothing spectacular, nothing controversial, about it. The utilities, on the whole, have had quite far-sighted leadership, insisting on service standards at least as high as those imposed by the commissions. Controversial or prosaic, service requirements are as important as rates; in fact, the reasonableness of rates should never be considered apart from the adquacy of the service in question."

[32] From *Elements of Utility Rate Determination by Bryant and Herrman, New York* (1940), page 219:

"What is a proper rate of return in one case, in one locality, or at one period of time, may not be the proper amount at some future date (*Waukesha Gas & E. Co.* v. *Wisconsin R. Comm.*, 181 Wis. 281, 194 N. W. 846, P. U. R. 1923E, 634: see also 203 Fed. 864) or in some other place. What the public requires is a solvent utility (*Quinn* v. *Harrisburg R. Co.*, Pa., P. U. R. 1920C, 106) operating in an efficient manner (Re *Lexington Water Co.*, Va., P. U. R. 1928E, 323), provided that the rates are not more than the service is reasonably worth. The law does not guarantee a profit from the undertaking at all times nor in all localities. (*Kings County L. Co.* v. *Lewis*, 110 Misc. 204, 180 N. Y. Supp. 570, P. U. R. 1920D, 145; *Smith* v. *Illinois Bell Tel. Co.*, 282 U. S. 133, 75 L. Ed. 265, 51 Sup. Ct. 65, P. U. R. 1931A, 1.) Competition from other forms of service may reduce the income of a utility and make future operation at a profit impossible. The full return on the fair value of the property is predicated on efficient operation. (Re *Lexington Water Co.*, Va., P. U. R. 1928E, 323.)"

Summarizing the record in the matter of service, we conclude that measured by normal standards the company's service to the public was unsatisfactory and inadequate before the war and is at this time unreasonably bad. Making full allowance for wartime difficulties, the record shows, and we so find, that the company's service could have been, and can now be, materially improved and that the company has not taken proper advantage of available means for betterment. In comparison with Municipal's performance, the company's service is distinctly inferior. All indications point to increased mass transportation service requirements, military and public, in San Francisco, with no relief in sight through the company's facilities, operating program, or management.

Traffic, Revenues, Expenses, and Effect of Fare Changes

For a period of seventeen years, until the beginning of the war boom in 1942, the company was faced with steadily diminishing operating revenues. The maximum revenue year was 1925 ($9,902,768), the minimum year was 1941 ($6,062,674), a decline of 39 per cent. In 1942 the operating revenue was $7,574,541, an increase due to the war of $1,511,867, or 25 per cent over the previous year, and for the 12-month period ended May 31, 1943, there was a further increase, from the same cause, to

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Further, page 222:

"Efficient management of a utility produces the service at lower operating costs than does poor management. Good service stimulates greater use by the customers. Both these elements should be considered in fixing the rate of return that should be allowed a utility."

Further, pages 224 and 225:

"The value of the service rendered has been mentioned as one of the elements to be considered in *Smythe v. Ames*, in which the court said the railroad could not charge more than the service was worth to the public * * * There is no rule at law by which the value of the service may be measured; but it has been stated that the value of the service is considered to be more important than the return to the utility. (Re *Helena L. & R. Co.*, Mont., P. U. R. 1920D, 668; Re *Pocatello Gas & P. Co.*, Idaho, P. U. R. 1923C, 25; Re *Alabama Util. Co.*, Ala., P. U. R. 1932A, 435; *Gay v. Damarascotta—Newcastle Water Co.*, 131 Me. 204, 162 Atl. 264, P. U. R. 1932E, 289.)"

$8,321,000. The largest factors in this loss of revenue prior to the rate increases in 1937-1938 were the competition of the private automobile and the Municipal Railway.

The financial results of the company's operations for the past 21 years and the disposition of total operating revenue are shown in the following table from Exhibit 10.

ar	Gross Maintenance Expense	Gross Operating Expense	Total Operating Expense*	Operating Taxes	Depreciation	Operating Income	Total Operating Revenue
22	$1,268,831	$5,591,207	$6,860,038	$604,200	$320,000	$1,799,199	$9,583,437
23	1,298,211	5,535,977	6,834,188	617,100	320,000	2,038,105	9,809,393
24	1,369,923	5,666,285	7,036,208	617,000	320,000	1,879,152	9,852,360
25	1,371,896	5,681,144	7,053,040	617,000	500,000	1,732,728	9,902,768
26	1,416,911	5,976,794	7,393,705	617,000	500,000	1,380,962	9,891,667
27	1,418,381	6,222,507	7,640,858	605,000	500,000	1,073,712	9,819,570
28	1,351,262	6,395,351	7,746,613	607,000	500,000	900,848	9,754,461
29	1,214,684	6,265,754	7,469,477	595,000	500,000	1,025,716	9,590,193
30	1,141,413	6,148,323	7,286,745	556,000	500,000	853,595	9,196,340
31	1,034,810	5,855,759	6,863,606	448,500	500,000	757,216	8,569,322
32	1,007,387	5,538,568	6,535,294	399,000	262,531	608,682	7,805,507
33	946,588	4,997,303	5,939,749	382,000	498,271	587,396	7,407,416
34	935,936	4,864,444	5,941,869	416,000	361,467	553,525	7,272,861
35	837,323	5,068,837	5,902,446	328,009	500,000	593,500	7,323,955
36	926,131	5,004,843	5,918,367	306,500	500,000	783,486	7,508,353
37	955,484	5,024,861	5,972,177	402,000	500,000	305,577	7,179,754
38	880,772	4,706,342	5,582,736	432,000	500,000	(40,234)	6,474,502
39	711,244	4,564,636	5,273,237	424,000	500,000	239,079	6,436,316
40	714,997	4,353,898	5,065,439	416,000	500,000	87,185	6,068,624
41	667,614	4,276,644	4,936,329	416,000	500,000	210,345	6,062,674
42	752,034	4,834,932	5,579,127	425,500	500,000	1,069,914	7,574,541
Mo. ded ril 43	841,335	5,171,527	6,007,028	422,500	500,000	1,281,786	8,211,314

* Reflects credits for Transportation for Investment and, in 1934 and 1935, additional ges under profit-sharing plan.

( ) = Red Figures.

Exhibits 1 and 10 show that miles of road operated (single track miles) were reduced from approximately 290 miles in 1922 to 220 miles at the end of 1942, a 24 per cent reduction. Offsetting the reduction in rail track mileage, to a certain extent, was the increase in bus route mileage, which at the beginning of 1938 was about 12 miles and in 1942 approximately 90 miles. Revenue car miles (including bus miles) were, in round numbers, 25 million in 1922 and 17,339,000 in 1942, a decrease of 31 per cent. The lowest point in revenue car miles was

reached in 1939 (16,814,000) and then they fluctuated in the three following years as follows: 1940, 17,044,000; 1941, 16,854,000; 1942, 17,339,000. Total passengers carried in 1922 were approximately 255 millions and in 1942 155,710,000, a reduction of 39 per cent. The lowest number of passengers carried is shown in 1940 (124,777,000). In the following two years there was an increase (1941, 126,241,000 and 1942, 155,710,000). It is interesting to note in this connection that in 1934 the total number of passengers carried was 205 million and for the following two years there was an increase, in 1935 to 207 million and in 1936 to about 215 million. In 1937 and in 1938 the rate increases heretofore referred to became effective and a precipitous drop in revenue passengers and total passengers occurred subsequent to such increases. The figures for the years 1937, 1938, 1939 and 1940 are as follows:

Year	Revenue Passengers*	Total Passengers Carried
1937	141,972,000	188,000,000
1938	111,787,000	144,439,000
1939	95,563,000	129,582,000
1940	89,924,000	124,777,000

* Excluding revenue transfer passengers.

The over-all effect of the Market Street fare increase on the San Francisco local transportation agencies was summarized by Mr. Hunter, who testified that during the five-cent fare period 1933 to 1936 Market Street carried 71 per cent and Municipal 29 per cent of the combined traffic and the revenue followed approximately the same divisions. During the three years 1939 to 1941, inclusive, with the company's fare at seven cents and the Municipal at five cents, the Market Street Railway carried only approximately 52 per cent of the combined fare passengers and received about 60 per cent of the combined passenger revenue.

It is apparent, however, that a considerable portion of passengers lost to Market Street, by reason of the fare

increases, did not subsequently make use of Municipal Railway. This is indicated in Exhibit 1, which shows that the combined traffic of Market Street Railway plus Municipal Railway did not equal the sum of the two separate revenue passenger figures prior to the rate increases. The reasons for this discrepancy seem obvious: a large percentage of lost Market Street revenue passengers consisted of so-called short-haul riders who refused to pay the seven cent fare and who were unable to go to the Municipal system by reason of non-availability of that system in many parts of the city. Mr. Kahn is in agreement with this view.[33] Not even the increased activity resulting from the Golden Gate International Exposition in 1939 and 1940 was able to overcome the continuous decline in passenger revenue on the company's lines. There is no doubt that the loss of short-haul passengers has continued and will continue on Market Street Railway lines during the present war period.

The entire evidence on this item compels the important conclusion that the company will reap no lasting financial benefit from rates in excess of the five-cent fare. For the prewar period this conclusion admits of no doubt whatever. The loss in revenue through loss of patronage was much greater than the gain from the increased fare. In the war period Market Street has gained, as have all transportation systems throughout the country, a large increase in passengers and revenue. This has come about by reason of the rubber shortage, gasoline rationing and the discontinued use of an increasing number of automobiles; together with the enormously increased industrial and military activities. In San Francisco these causes

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[33] "MR. APPEL: When the Market Street Railway Company lost riders in 1938 and 1939 did the Municipal Railway absorb all of those riders? A. No, nor was it anticipated that it would absorb all the riders because a careful analysis was made at that time and on lines of Municipal Railway that paralleled those of Market Street Railway it was anticipated that a certain percentage of the riders would shift from Market Street Railway to Municipal Railway, but on other parts of the system which were non-competitive, such a shift of revenue passengers due to the increased fare was not anticipated at all.

"Q. Nor did it take place? A. No."

have had very pronounced impact on the local transportation system and have brought about a great increase in traffic. The demand, this record shows, greatly exceeds the supply, especially during rush hours. This situation will not last. As soon as transportation conditions return to normal the company's seven-cent fare will again be hopelessly handicapped, as it was before the war, against the competing five-cent Municipal fare and the company's financial showing under present conditions of service will be no better than it was in 1941 and 1942. It will grow worse unless the service is greatly improved.

Position of City of San Francisco

The position of the City and County of San Francisco was stated by Angelo J. Rossi, Mayor of San Francisco, and by Edward G. Cahill, manager of the Public Utilities of San Francisco. Mayor Rossi testified that in his opinion "the transportation problem of San Francisco will never be solved until we have a unified system, one fare and one ownership" and further "I am still of the opinion that the only way to do it would be to devise some plan, self-liquidating plan, where the city would eventually own the property of the Market Street Railway Company." The Mayor reviewed the attempts made, in the elections heretofore referred to, to have the people of San Francisco vote bonds to acquire this street railway property. He testified that the Municipal system operating under a five-cent fare showed "a profit now of over a million dollars a year" and that the city had accumulated a good surplus and was willing "to spend that money for equipment if and when the Federal Government will permit us to."

Mr. Cahill testified that the San Francisco Public Utilities Commission strongly advocates a uniform five-cent fare and free universal transfer. He opposed a charge for a transfer between the privately owned and the Municipal systems and testified that such transfer would not be worth as much as one cent.

Our Department of Finance and Accounts introduced evidence showing Comparative Balance Sheet, Profit and

Loss Account, Comparative Income Statement, Operating Revenues and Operating Expenses for the five years 1938 to 1942, inclusive; all taken from the company's sworn annual reports filed with the Commission and from the company's records. Reference has heretofore been made to the earnings of the company during the past twenty years. The record is clear that prior to the war the five-cent fare produced a greater gross and net annual revenue than any fare in excess of five cents.

What increase in traffic a five-cent fare would bring at the present time is not certain, but there is no doubt that it would be substantial particularly at the off-peak periods and also for the reason that a large number of lost short-haul riders would return to the company's lines. In the eight months' period, January to August, inclusive, of 1943, the operating revenues of the company amounted to $5,689,775, compared with $4,737,856 for the same period in 1942, an increase of twenty per cent. On this basis the total for the full year of 1943 under a seven-cent fare may be expected to be about $8,700,000. If operating expenses increased to $7,940,000, including $750,000 for depreciation and $590,000 for taxes the net operating revenues would be $760,000, which is a return of 9.6% on $7,950,000,[34] the

[34] The only available indication in this record of the present value of the company's properties used and useful in the public service is the resolution of its Board of Directors, passed on March 25, 1943. The resolution (Exhibit 9) reads as follows:

"Sale of the Operative Properties of the Market Street Railway Company to the City and County of San Francisco. The President advised the Board that he had agreed with the Mayor and other city officials, as well as the Board of Supervisors, to sell the operative properties of Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000.00 cash, which was the same amount agreed upon for the sale of the operative properties when a charter amendment for the purpose of raising such sum by a revenue bond issue was submitted to and rejected by the qualified electors of the City and County of San Francisco at the general election on November 3rd, 1942. The President stated further that a similar charter amendment with several changes therein, for the purpose of raising the sum agreed upon for the sale of the operative properties of the Market Street Railway Company to the City and County of San Francisco by a revenue bond issue would be sub-

price at which the company offered to sell its properties to San Francisco in 1942 and again in 1943. If a depreciation allowance is made of $500,000, as set up by the company in previous years, the net operating revenues would be $1,010,000, or a return of 12.7% on said $7,950,000. Both of these rates are excessive and unjustified by the present service.

We express no opinion on the reasonableness of the figure of $7,950,000 as an exact measure of the present fair value of the company's operative property in its present depreciated physical and service condition, with its past earning record and its prospective future under the competitive transportation situation obtaining in San Francisco. We accept the figure as the amount for which the company was willing to sell to the city of San Francisco. Here is an offer by a willing seller, first made in September 1942 and rejected in an election by an unwilling buyer, the voters of the City and County of San Francisco. The same offer was again made six months later by the same willing seller and was again rejected by the same unwilling buyer.

The legal test of "present fair market value" assumes a willing seller and a willing buyer. This legal assumption holds, as in utility condemnation cases, even if the

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mitted to the qualified electors of the City and County of San Francisco at a special election to be held on April 20, 1943. The President also stated that the price mentioned is the amount that had been agreed upon for the purchase by the City and County of San Francisco of the operative properties of the Company after negotiations in respect thereto which covered a considerable period of time and, as previously mentioned, is the best price obtainable therefor.

"Whereupon, On motion of Director Fay, duly seconded by Director Scott, the following resolution was adopted.

"Resolved, That the actions of the President in negotiating the sale of and agreeing to sell the operative properties of the Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000.00 cash be, and the same hereby are, ratified, approved and confirmed; and it is

"Further Resolved, That the officers of the Market Street Railway Company be and they are hereby authorized and directed to perform all necessary and proper acts in order to carry out and complete the sale of the operative properties of the Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000 cash."

seller is unwilling to sell. Here the prospective buyer has repeatedly expressed his unwillingness to buy. It may be taken for granted, therefore, that the price set by the seller is not too low. Nor can it be said that the potential buyer was not fully informed of all the essential facts and circumstances relating to this property. In the last, as in the previous elections the matter had been fully and forcefully presented to the people of San Francisco. The last two offers, it should be noted, were made at a time of abnormally high war traffic and revenue and reflected the temporarily high earning capacity of the company under the present fare.

The fixing of a five-cent fare on a twelve months' basis, without any allowance whatever for increased traffic, and including in operating expenses $500,000 for depreciation, would result in a deficit of about $1,153,000. On the basis of the record the indications are that with a five-cent fare a 25% to 30% increase in traffic would be required to produce an income, after allowing for increased operating costs, to meet all expenses, including depreciation and taxes, and leave the company with approximately 5% return on the $7,950,000 base figure. Such a result, with efficient management and the proper use of all available equipment and plant, might reasonably be brought about. An increased use by the public of all mass transportation facilities must definitely be expected in San Francisco, not only because of further reduction in the gasoline allowance and the declining number of automobiles, but also in view of the certain increase of direct and indirect war activities in this area.

Considering the entire record in this case, we conclude that the continued charge of the seven-cent fare on the lines of the Market Street Railway Company is not justified by either the present service or the past service since the granting of the rate increases by this Commission in 1937 and 1938, and produces an excessive rate of return. Not only has there been no betterment in the unsatisfactory service conditions existing at the time of the rate increases, and which these increases were intended to render, but the condition of track and equipment and the character and quality of the service furnished the company's customers have

grown progressively worse, until in 1941, 1942, and in this year the standard of service has reached the lowest point in the company's history. The war, it is true, has aggravated this condition, but the record is clear that the service was unquestionably poor and inadequate before the war. It was and is poorer and less adequate than the competing Municipal service rendered the public at a five-cent fare. The two-cent increase in Market Street fares, it has been shown, did not, before the war improve the company's earning position and will again produce a loss under more normal transportation conditions. Gross and net earnings prior to 1942 fell to the lowest point in more than 20 years and the loss in revenue passengers heavily outweighed the increase in the fare. The company, prior to the war, would have been financially much better off under the continued five-cent fare.

The record clearly indicates that the number of revenue passengers will be substantially greater with a lower fare than with the present seven-cent rate. In the prewar period we may safely assume that this number, with a continued five-cent fare, would have been about as large, taking into account abandoned lines and expansion of Municipal operations, as it was prior to the rate increases in July 1937. The fare increases in 1937-1938 were gradual and experimental. We think a decrease at this time should also be gradual and must of necessity be experimental. We shall, at this time, reduce the Market Street Railway Company fare by only one cent and fix a six-cent cash fare as an interim rate. Consideration of service alone and of the value of such service to the patron would justify the fixing of a five-cent fare.

We expect the company to make every reasonable effort to improve the present unsatisfactory and inadequate service and to put all available equipment into operation. With a six-cent fare it is our expectation, based on the evidence available from the record and from the company's past and present experience, that an annual revenue of approximately $8,500,000 will be produced. Operating expenses, including taxes and $750,000 for depreciation, we estimate, will amount to about $8,000,000, leaving a net

operating income of about $500,000, corresponding to an approximate rate of return of 6% on the base figure of $7,950,000. Such a return would be more than adequate under existing conditions.

We find that a six-cent fare, under the circumstances reflected in this decision, is a just, fair, and reasonable rate, provided, however, that every possible and reasonable effort will promptly be made by the company to furnish an improved service. We shall expect the company to file, in the form designated by us, monthly reports showing service and traffic conditions, and the financial results of operation.

This proceeding will be kept open for such further investigation and such further order or orders as may be necessary and just and reasonable.

We adopt the following order.

Order

The Commission having instituted an investigation on its own motion into the reasonableness of the rates, practices, and service of the Market Street Railway Company, public hearings having been held, the Commission being apprised of the facts, and the matter being under submission and ready for decision, and based upon the foregoing opinion:

It is ordered that Market Street Railway Company is hereby directed and authorized to file, on the effective date of this order, and to make effective upon one (1) day's notice to the Commission and to the public, the following change in its fare structure for the transportation of passengers between points on its system in San Francisco:

> Base cash fare, or token fare, changed from seven (7) cents to six (6) cents;
> Other present fares to remain in effect, including the established free transfer privileges between the various lines of this carrier as well as the established transfer arrangment between Market Street Railway Company and both the lines of San Francisco Munici-

pal Railway and the California Street Cable Railroad Company.

It is further ordered that Market Street Railway Company shall file with this Commission, in addition to the information required by General Order No. 65,

(1) a monthly statement showing the traffic carried, segregated as to the different classes of fare;

(2) a monthly statement, in the form approved by the Commission, showing changes in service and in manpower conditions.

The information referred to in (1) and (2) shall be filed with the Commission not later than twenty (20) days following the termination of the month of operation.

It is further ordered that this proceeding shall remain open for further investigation by the Commission.

It is further ordered that the Commission reserves the right to make such further order or orders in this proceeding as to it may seem right and proper.

The effective date of this order shall be twenty (20) days from the date hereof.

Dated at San Francisco, California, this 30th day of November, 1943.

FRANCK R. HAVENNER
RICHARD SACHSE
FRANK W. CLARK
Commissioners.

Certified as a true copy. (Seal) H. G. Mathewson, Secretary, Railroad Commission of the State of California.

Concurring Opinion

I concur in the opinion of my fellow commissioners and am in accord with the Commission's order in this proceeding. There is found in this record, however, much testimony not mentioned in the preceding decision and of importance in support of the Commission's order and I think reference should be made to some of this testimony.

The decision emphasizes, rightly I believe, the well-established economic and legal principle that the rate to be paid by the public for a utility service must bear a reasonable relationship to the value, quality and character of such service. In this case we are considering the value of street railway service not from a theoretical viewpoint but in the light of the actual transportation conditions as we find them in San Francisco at the present time and as they have existed for a number of years. The service of the Municipal Railway permits of a direct comparison with Market Street Railway service. The steady decline in the adequacy and quality of the company's service during the last ten years, and the fact that the rate increases granted by this Commission in 1937 and 1938 did not correct that decline, is amply substantiated in this record. The war has forced the acceptance by the car riders of still poorer and more inadequate service, while the company is profiting from the abnormal increase in traffic and congestion by high net revenue and an unreasonably high rate of return.

These facts as they are set forth in the preceding opinion sufficiently support the Commission's order. The courts have generally required, however, in addition to the test of the value of the service to the rate payer, a second test of the reasonableness of a public utility rate, viz., the reasonableness from the standpoint of the utility. The Commission may not fix a rate resulting in confiscation of the company's property used and useful in the public service. This test requires a consideration of past and present revenues and expenses, of investment and rate base, of rate of return and an intelligent consideration of these items in the probable near future. Further, we must not ignore any other important and relevant fact having a bearing on the reasonableness of the rate both to the utility and the ratepayer. All of these requirements are understood of course, and recognized by the Commission. The preceding opinion refers only briefly to these items, although the record is by no means silent on the requirements of this second test of a just and fair utility rate.

Earnings

The record shows that the company's net earnings after proper operating expenses, including depreciation and taxes, have at no time during the five years 1937 to 1941, inclusive, produced sufficient income to meet fully the company's fixed charges. This is apparent from Exhibit 1, where the column "Deductions from Gross Income" indicates payments for interest on funded and unfunded debt, amortization of discount on funded debt and certain small items of miscellaneous debits. The figures for the five-year period taken from the exhibit are as follows:

(Here follows 1 Exhibit)

Year	(a) Operating Revenue	Operating Expenses Excluding Depreciation and Taxes	Depreciation	Taxes	Operating Income	Non-Operating Income (Net)	Gross Income	Deductions from Gross Income	Net Income
	$	$	$	$	$	$	$	$	$
1937	7,179,754	5,972,177	500,000	402,000	305,577	10,588	316,165	484,115	(167,950)
1938	6,474,502	5,582,736	500,000	432,000	(40,234)	10,840	(29,394)	466,431	(495,825)
1939	6,436,316	5,273,237	500,000	424,000	239,079	6,979	246,058	451,008	(204,950)
1940	6,068,624	5,065,439	500,000	416,000	87,185	5,720	92,905	358,715	(265,810)
1941	6,062,674	4,936,329	500,000	416,000	210,345	8,267	218,612	333,422	(114,810)

( ) = Red Figures.

(a) = Consisting of Passenger Revenue and Other Revenue.

This unsatisfactory earning condition, including the period during which the 40 per cent rate increase from 5 to 7 cents granted by the Commission was in effect, was in fact worse than shown in the preceding tabulation. This is true for the reason that the company throughout its entire history has made inadequate provision for depreciation of its operative property. Further, such insufficient and arbitrary depreciation appropriations as have been made from year to year since 1921 have in part been expended not for the necessary replacements of fully depreciated plant and equipment but in payment of interest and for other purposes not related to maintenance of service and renewal of plant. The cost of depreciation is an operating expense and is allowed for specific replacement purposes.

Witness Mors, the Commission's transportation research engineer, in Exhibit 10 states, in part, as follows:

> "The annual appropriations appear to have been decided upon arbitrarily and not based upon any depreciation study. For the first four years 320,000 was added to the reserve each year, and since 1924 the appropriation has been $500,000 per year, with the exception of three depression years, 1932, 1933, and 1934, when it varied from $263,000 to $498,000."

Exhibit 10 shows that the depreciation appropriations made by the company were insufficient and that if proper depreciation rates had been applied to the recent depreciable property, based upon a valuation made in 1920, a straight line annual depreciation accrual of approximately $780,000 would be required. Witness Mors in Exhibit 10 says:

> "Had adequate depreciation expense been charged against operations and credited to the depreciation reserve, the company would have shown a net operating loss each year for at least 5 years prior to 1942. If adequate provision is not made or cannot be made

for current depreciation the inevitable result is that some of the capital investment is consumed."

A review of the record with reference to the company's earnings in relation to the service offered its customers establishes the important fact that no rate of fare, 5 cents or higher, would or could in prewar and normal times produce any operating profit or any rate of return on any property valuation or rate base. The operations of the company under the service conditions as they existed in the five years prior to 1941 produced an annual deficit each year and the deficit was greater in the years when the increased fares were charged than during the 5-cent fare period. Only an improved service, with more modern and economical plant and equipment, under reasonably efficient management, and in financially solvent ownership, could have brought about profitable operation under fair and reasonable rates. The same compelling economic forces will be operative in the future and no sound purpose is served by ignoring these realities.

Investment, Rate Base, Rate of Return

The road and equipment account of Market Street Railway is not segregated by primary accounts, as provided for in the Uniform System of Accounts for Electric Railways, but is carried in the books as the sum of two accounts, namely (1) Railroads, Properties, and Franchises, and (2) Additions and Betterments to Road and Equipment.

The company's general ledger shows the following amounts in these two accounts as of April 1, 1921:

Ac. 401—Railroads, Properties, and Franchises	$46,775,296.95
Ac. 401—Additions and Betterments to Road and equipment	75,973.96
Total Road and Equipment	$46,851,270.91

Additions and betterments and retirements have been reported annually to the Commission by primary accounts. These are summarized in Table 6-1 of Exhibit 10, the additions by groups of property and the retirements in total.

The book amount of road and equipment as of December 31, 1942, $41,768,505, was 87 per cent of the amount in the peak year 1926.[35]

The Commission has never investigated the correctness or reasonableness of the company's book entries and to what extent they represent actual cash investment in present used and useful property, and to what extent predecessor book entries, valuation writeups and so-called intangibles are represented in the original 1921 entry. There is included in the December 31, 1942 total the sum of $5,119,191.30 for "General and Miscellaneous," including $847,953.20 Law Expenditures; $3,133,405.47 Interest During Construction, and $571,415.47 Miscellaneous.

The Commission's Department of Finance and Accounts (witness Donovan) introduced Exhibit 2, showing Comparative Balance Sheet, Profit and Loss Account, Comparative Income Statement, Operating Revenues and Operating Expenses for the five years 1938 to 1941, inclusive; taken from the company's annual reports filed with the Commission, and from company records. Below is reproduced the bal-

[35] In response to a request by the Commission the company submitted with its 1941 and 1942 annual reports a segregation of road and equipment by primary accounts. In submitting this schedule in 1941 the company made the following statement in a letter to the Commission:

"As requested, we are enclosing as a supplement to our 1941 report, Schedule 211, Road and Equipment, segregating this investment as between rail and motor coach properties.

"This schedule, for the first time, gives a breakdown of property values by primary accounts; which values have been obtained from a schedule prepared by Mr. A. R. Franklin in an income tax case some time ago. The motor coach values at December 31, 1940, with the exception of Account 530, represent the estimated value of our investment in our motor coach garage, formerly our Twenty-fourth Street Car House, the value being obtained from the Railroad Commission's valuation of 1920."

ance sheet, with primary asset and liability items, as of December 31, 1942:

Assets and Other Debits	
Road and Equipment	$41,769,229.27
Sinking Funds	27,352.76
Investments	3.00
Current Assets	1,571,705.03
Unadjusted Debits	165,204.61
Reacquired Long Term Debt	25,000.00
Total Assets and Other Debits	$43,558,494.67
Liabilities and Other Credits	
Capital Stock Outstanding	$31,926,450.00
Long Term Debt	5,994,873.96
Current Liabilities	906,476.00
Unadjusted Credits Other than Reserves	187,424.18
Reserves	1,274,500.31
Profit and Loss	3,268,770.22
Total Liabilities and Other Credits	$43,558,494.67

In the liability item "Reserves" is included a depreciation reserve of $1,023,886.71. Applying normal accounting methods and practices, this would indicate a depreciated investment in road and equipment of $40,745,342. Obviously this figure has no relation whatever to the actual depreciated value of this company's operative property in its present condition.

The so-called investment figures, depreciated or undepreciated, have no bearing on property value, rate base or actual accrued depreciation, as such factors would be considered in a rate case or in the present proceeding. This is evident from a comparison of the balance sheet asset totals with the company's offer to sell its operative property to the City of San Francisco for $7,950,000 cash.

A historical cost vaulation was made by the Commission's engineering department as of June 30, 1920, upon the request of the city. It may be noted that this June 30, 1920

valuation compares with the April 1, 1921 company's investment figure as follows:

(1) Company figure: Investment, Road and Equipment, undepreciated, April 1, 1921	$46,851,271
(2) Historical Cost Estimate, undepreciated, June 30, 1920	29,715,147
(3) Difference	$17,136,124

It is not practicable to bring these figures to reliable present amounts for purposes of this case. The accumulated depreciation in the property to 1943 would have to be ascertained and deducted from an undepreciated historical cost estimate, taking account also of retirements and additions and betterments, and new capital expenditures, in order to produce a present historical cost valuation estimate. This large task has not been undertaken and is not required and would be of no assistance, in my opinion, to reach a sound and fair decision in this case. A better measure of the maximum present value of the operative property is available and has been given consideration in the Commission's decision.

Nor is a reproduction cost estimate, undepreciated or depreciated, as of the present date required for the purposes of this case and if so large, costly and time-consuming task were undertaken the result would not assist the Commission in reaching a just and fair decision. This is apparent for several reasons: A reproduction cost estimate on any basis could only be speculative and theoretical, since under no conceivable circumstances would this property be reproduced in its present shape, including cable cars and other obsolete property, and in its present neglected and inadequate physical and service condition. Any attempt to estimate present day costs of duplicating the existing plant and equipment would run into absurdities and contradictions. Cable car systems are no longer constructed, nor could much of the existing electric rail equipment be purchased today. It is no longer produced and more modern, more efficient and economical street cars have been available for

years. In no event would a number of the company's rail lines be rebuilt or reproduced since better and much more profitable motor coach service would in reality be substituted. There is the further consideration that during the war period no reproduction could in fact take place; construction materials and equipment cannot be purchased; construction labor is not to be had; present costs and prices for such reproduction and construction cannot be ascertained.

The fact that the true present value of an obsolete street railway system cannot be found by a historical reproduction cost estimate, or by estimates of reproduction cost new, depreciated or undepreciated, or by review of original book cost, has been repeatedly demonstrated in proceedings before this Commission. The most recent such demonstration is the Sacramento street railway, where in Decision No. 36,663, decided this month, the Commission approved the sale of this electric street railway and motor coach property for $450,000, when at the same time the undepreciated historical cost of this property was $2,318,699.[36]

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[36] In Decision No. 36663, in Application No. 25794 of Pacific Gas and Electric Company to sell its electric street railway and motor bus transportation system in the City of Sacramento to Sacramento City Lines, the Commission says: "In Exhibit 3 filed at the hearing had on this application the undepreciated historical cost of the Sacramento street railway and motor bus line properties to be sold to Sacramento City Line as of September 10, 1943, is reported at $2,318,699. It is of record that this cost is predicated upon the company's 1919 historical appraisal and that to such appraisal has been added the net book cost of additions and betterments. Pacific Gas and Electric Company's books as of August 31, 1943 show against such properties a reserve for accrued depreciation of $841,026. The company has agreed to sell the properties to the Sacramento City Lines for the sum of $450,000 plus the assumption by Sacramento City Lines of Pacific Gas and Electric Company's contractual and other lawful obligations in connection with the ownership and operation of said properties other than pending actions or subsequent torts or court actions arising out of incidents that shall have occurred prior to the actual transfer of said properties to Sacramento City Lines and exclusive of Pacific Gas and Electric Company's bond mortgage or deed of trust. Sacramento City Lines will assume the payment to the City of Sacramento of $50,000 if and when it abandons the operation of the Number 3 car line and the Number 6 car line. This liability is covered by an agreement of April 17, 1942 by and between Pacific Gas and Electric Company and the City

If the offering price set by the company for its property is accepted as a measure of present value and as a rate base, we find net earnings and rates of return for the last five years as follows:

(1)	(2)	(3)	(4)	(5)	(6)
Year	Rate Base (a)	Operating Income (b)	Operating Income (c)	Rate of Return (d) Per Cent	Rate of Return (e)
1938	$7,950,000	$ (40,234)	$(320,234)	(0.51)	(4.03)
1939	same	239,079	(40,921)	3.01	(0.51)
1940	same	87,185	(192,815)	1.09	(2.43)
1941	same	210,345	(69,655)	2.65	(0.88)
1942	same	1,069,914	889,914	14.72	11.19

( ) = deficit.

Notes:

(a) Rate Base, column (2), for purposes of this calculation, is assumed the same for each year; value of property should be lower prior to 1942 because net earnings were much smaller or altogether absent.

(b) Operating income, column (3), according to company's accounting methods, is operating revenue, less operating expenses, taxes, and depreciation in amount apportioned by company of $500,000 each year.

(c) Operating income, column (4), is adjusted by fixing depreciation expense in the more nearly adequate amount of $780,000, as testified to by Research Engineer Mors. Company has increased depreciation expense for 1943 to $750,000.

(d) Based on column (3).

(e) Based on column (4).

All valuation estimates of reproduction cost, or historical cost, together with consideration of book cost, investment figures, value of securities and other criteria of property value have, in rate cases, one main purpose: to assist in the finding of the present fair value of the operative property. In this proceeding we have the management's and the company's board of directors' final judgment of present value expressed not as an estimate or a theoretical figure but in the form of a binding offer to sell at a definite price. Such a determination of present value, it seems to me, is consistent with the actualities and much superior to speculative engineering and accounting estimates.

In its decision the Commission has estimated that a 6-cent fare will produce an approximate rate of return of 6 per cent on the base figure of $7,950,000. The company itself,

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of Sacramento, which agreement is filed in this application as Exhibit 2. "It is of record that Pacific Gas and Electric Company may sustain, on account of the sale of the properties, a book loss of about $1,027,673. It is the company's intention to charge this to surplus, subject to an offset resulting from a tax saving because of the loss."

according to the record, can determine within considerable limits what its net earnings and rate of return will be under the 6-cent fare. If better service is provided and the maximum amount of the available equipment placed in operation, greater net revenues and a higher rate of return will of course be obtained than with poor service and much idle equipment. The continued investigation of the company's affairs and the filing of monthly traffic and service reports as provided for in the order will enable the Commission to take whatever appropriate action may further be required in this proceeding.

[SEAL.] RICHARD SACHSE,
Commissioner.

Concurring Opinion

Commissioner C. C. Baker and Justus F. Craemer

In view of the case-history of the Market Street Railway Company of recent years, as reflected from the record herein, our opinion is not in conflict with the conclusion of the majority with respect to the objective of providing for a material improvement in the quality of the service, nor in conflict with the conclusion that the basic fare be reduced to six cents, upon an experimental basis. By reason thereof, and upon the distinct understanding that such fare reduction is to be deemed experimental in character, under wartime conditions, we hereby concur in the said twofold conclusion as set forth in the attached decision.

Viewed as a plan whereby to determine the operating conditions that would obtain through the combination of improved service and a reduced fare structure, together with the fact that the results thereof must be considered decidedly problematical, it is our view that the experimental period should not be of indeterminate duration, but rather for some specific unit of time, during which period the required reports, together with other pertinent matter, would be subject to review by the Commission's staff, as well as by other interested parties, to the end of determining whether a continuation of the experiment be justifiable.

There can be no doubt, of course, but that operations during a reasonable experimental period, upon the basis indicated, will afford an opportunity to test the conclusion of the majority in the face of conditions rendered both abnormal and extraordinary by reason of war-time activities.

It is likewise obvious that, during such experimental period, the volume of traffic on the Market Street Railway System must be materially increased, for otherwise the proposed plan cannot effect a solution of the problem. Such increase in the volume of traffic, of course, will necessitate an increase in the frequency of the service, which in turn, will require both additional equipment and additional manpower, with attendant increase in the cost of operations. All this may be achieved, with attendant benefit to both the transportation agency and the patronizing public. On the other hand, the result may be wholly negative with reference to the desired end. It is thus primed with the element of conjecture.

This proceeding was instituted by the Railroad Commission on its own motion. It thereby assumed full responsibility in the premises, including the burden of proof. But should the experiment fail of its objective, upon the basis of an indeterminate experimental period, then, in such event, the burden would be shifted to the respondent. It would be otherwise in this particular if the proposed plan were based upon an experimental period of specific duration. Furthermore, should the proposed plan prove ineffective, the necessary adjustments to follow would be much more simple, from the standpoint of procedure, and involve much less expense, if the experimental process were subject to a definitely defined period.

We deem it a matter of regret, therefore, that the majority hold to a contrary view with respect to the fixation of a definite experimental period, like unto the practice of the Interstate Commerce Commission in certain cases of recent times, as against the indeterminate period that will obtain under the said majority decision.

For the reason thus indicated, together with other reasons, it is not without reluctance that we thus concur in the conclusion of the majority, as hereinbefore specified.

This is, therefore, a concurrence with both limitations and reservations. And it is to be further understood that nothing herein contained may be construed as a concurrence in, or an adoption of, those portions of the majority opinion not herein subjected to specific objection; for be it known that we are in disagreement with the majority opinion with respect to certain of the reasoning processes therein noted, as well as to a number of the assumptions and deductions thereof, and also with reference to the relevancy and the application of some of the cases therein cited in support of the line of reasoning of the majority opinion.

C. [redacted] Baker,
Justus F. Craemer,
[SEAL] *Commissioners.*

EXHIBIT 2

Decision No. 36,821

Before the Railroad Commission of the State of California

Case No. 4680

In the Matter of the Investigation Upon the Commission's Own Motion into the Reasonableness of the Rates and Charges, and into the Sufficiency and Adequacy of the Operations, Service, and Facilities of the Market Street Railway Company.

Cyril Appel, Ivores R. Dains, and Samuel Kahn, for the Market Street Railway Company.

Angelo J. Rossi, Mayor; John J. O'Toole, City Attorney; Dion R. Holm, Assistant City Attorney, and Paul Beck, for the City of San Francisco.

Mrs. Helen Negrin, in propria persona.

Additional Appearances on Petition for Rehearing:

Felix T. Smith and Henry G. Hayes, for Market Street Railway Company.

Douglas Brookman, for Congress of Industrial Organizations (CIO), and George Wilson, President of CIO.

Opinion on Petition for Rehearing

By the Commission:

Petition for rehearing of the Commission's decision No. 36739 rendered November 30, 1943, was filed by the company on December 9, 1943. On December 15, 1943, we made our order granting oral argument before the Commission en banc and extending the effective date of decision No. 36739 until further order by the Commission. Argument was heard on December 21 and 22, 1943, Mr. Felix Smith arguing for the company, Mr. Dion R. Holm for the City and County of San Francisco, and Mr. Douglas Brookman for the Congress of Industrial Organizations, which has in excess of 35,000 members in San Francisco, who with their families constitute a very substantial group of riders on the street railway system of the company. Permission was granted to representatives of various organizations and to individuals present at the hearing to express their views on the matter before us.[37]

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[37] Dr. L. W. Hosford, President of Jefferson Lafayette Improvement Club, et al.

Mrs. Gertrude Lincoln, for Women's Welfare League, et al.

Eugene E. Pfaeffle, President of San Francisco Retailers' Protective Association.

George W. Gearhard, Secretary of Civic League of Improvement Clubs and Associations of San Francisco.

J. F. Calverley, President of Southern Council of Civic Clubs.

Mrs. Sulvina Ratto, Financial Secretary of Central Mission Improvement Association.

Adolph Petry, Chairman of Transportation and Traffic Committee of the Central Council of Civic Clubs.

Erwin C. Easton, Attorney for North Central Improvement Association.

Mrs. Rose Walker, President of Greater Mission Improvement Association.

R. J. O'Rourke, President of San Francisco Property Owners' League.

Lloyd Taylor, Executive Secretary of Market Street Association.

According to its petition the company seeks a rehearing on the following grounds:

(1) That due process of law has been denied the company

> "in that the Commission has ordered the company to reduce its rates or fares without giving notice that it was being charged with the maintenance of rates that were unreasonably high, or in any other respect unlawful, and without according a fair and complete hearing upon that issue";

(2) that the Commission

> "has acted arbitrarily and capriciously, in that it has ordered a reduction in the company's rates without having any substantial evidence before it that the rates now charged are in any respect unreasonable";

(3) that the Commission's order reducing the company's rates from seven cents to six cents

> "amounts to a taking of its property without compensation and the confiscation of its property".

In general, our order is alleged to be in violation of the Constitution of the State of California and of the 14th Amendment to the Constitution of the United States.

These three allegations are subdivided and elaborated in the petition for rehearing and it is the purpose of this decision to consider them on the basis of the present record in some detail.

The Company Did Have Notice That the Reasonableness of Its Street Railway Fares Were at Issue in This Proceeding and Was Accorded a Fair and Complete Hearing Upon that Issue.

The petition alleges that "At no time during the hearing was any statement made by the Commission which would put the Company upon notice that the reasonableness of its rates was an issue or that it must be prepared to meet that issue". This is an astounding statement in view of

the record and is completely contradicted by the nature, scope, and course of the present proceeding. The title of the proceeding, the text of our order instituting this investigation on the Commission's own motion,[38] the opening statement of the presiding Commissioner on May 10, 1943, the first day of the hearing,[38a] all gave clear, definite, and unmistakable notice to the company that the reasonableness of its rates and charges, as well as its service and facilities, would be investigated by the Commission. We proceeded with this case in method and in form exactly as in other similar proceedings involving rates and service of transportation and other utilities.[39] It may be said that

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[38] The first two paragraphs of the Order Instituting Investigation read as follows:

"The Commission believing that public interest demands an inquiry into the reasonablness of the rates, as well as the sufficiency and adequacy of the service rendered by the Market Street Railway Company; therefore, good cause appearing,

"It is ordered that an investigation be and hereby is instituted upon the Commission's own motion into the reasonableness of the rates, charges, classifications, rules and regulations of the Market Street Railway Company, and also into the reasonableness, sufficiency and adequacy of the operations, service and facilities of said Company."

[38a] "Commissioner Havenner: The Commission will be in order. This is the time and place set for the hearing in Case No. 4680, in the matter of the Commission's investigation into the reasonableness of the rates and charges and into the sufficiency and adequacy of the operations, service and facilities of the Market Street Railway Company." (Tr. 2.)

[39] Among proceedings on the Commission's own motion into the reasonableness of rates and service have been the following:

Case 4688, Vallejo Electric Light & Power Company (current proceeding).

Case 4672, Vallejo Bus Company, decision 36242, 3-23-43.

Case 4612, Bay Cities Transit Company, decision 36042, 12-15-42.

Cases 4621-2, Pacific Gas & Electric Company (gas service), decision 36082, 12-29-42.

Case 4478, Interurban Electric Railway Company, Key System, East Bay Transit Company (1940) 43 C.R.C. 181.

Case 4461, Pacific Electric Railway Company, Los Angeles Railway Corporation, Los Angeles Motor Coach Company (dismissed by decision 36338).

Cases 3477, 3604, Southern California Telephone Company et al. (1934) 39 C.R.C. 164.

this form of procedure in rate and service cases brought upon the Commission's own motion, has over a period of more than thirty years been a regularly established and recognized practice of this Commission. This same practice is regularly followed by other state and federal commissions.

The company's management and its counsel understood that this was a rate as well as a service investigation and recognized that service and rates were inseparable and interdependent and must necessarily be considered together. Mr. Kahn, the company's president, appearing as the company's first witness, testified from a prepared statement, commenced his testimony with a review of the rate situation since 1937 when the 5-cent fare was in effect. He reviewed several rate changes authorized by the Commission and their effect upon the company's traffic, revenue, and service. (Tr. 235 et seq.) He similarly reviewed (Tr. 246) the company's experience with the 7-cent fare and introduced company's exhibit No. 22, estimating what income in his opinion a 5-cent fare would have produced during certain periods in the years 1937, 1938, and 1939. Mr. Kahn's testimony was in fact addressed principally to the matter of rates and to the revenues produced by various rate structures.

Mr. Appel, company's counsel, through Mr. Kahn introduced in evidence company's exhibits Nos. 24 and 25, which are this Commission's decisions Nos. 31472 and 31603, respectively, in application No. 21115. That application was made by the company in 1938 for an order of this Commission "authorizing emergency increases in certain fares" and the decisions referred to, granting experimental increases, are rate decisions. Decision No. 31472, rendered on November 23, 1938, and reported in 41 C. R. C. 651, re-

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Case 3153, San Diego Consolidated Gas and Electric Company (1935) 39 C.R.C. 261.

Case 3008, San Joaquin Light and Power Corp. (1932) 37 C.R.C. 530.

Case 3026, Midland Counties Public Service Corp. (1932) 37 C.R.C. 530.

Case 3424, Pacific Gas and Electric Company (natural gas) (1933) 39 C.R.C. 49.

viewed the prior rate decisions numbers 29889 and 30849 theretofore rendered in the same proceedings and stated "In decisions numbers 29889 and 30849, the foundation was laid to again review the entire matter if the respective fare structures authorized did not prove to be satisfactory".[40]

It must be remembered that the decisions referred to were made in compliance with the company's application to authorize "emergency increases in certain fares". The company, under the rules of the Commission, has regularly filed revenue and operating statistics and the Commission has continually kept abreast of the results of the fare changes. In a real sense, therefore, this has been and is now a continuing rate investigation. The Commission's order in the present case is made on that basis and provides for the regular filing with the Commission of future monthly traffic, revenue, and service statements and provides further "that this proceeding shall remain

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[40] In Decision No. 29889, 40 C.R.C. 525, the first decision in application No. 21115, the Commission said:

"In reviewing this record, the Commission is not convinced that applicant's proposed fare structure is one which best meets the situation, in fact the President of the company has stated that no consideration has been given to any other form of fare (Tr. p. 52); that the estimates were of necessity only a guess; and that experience alone could tell what results would obtain if the proposed fare structure were put into effect.

"The Commission has given considerable thought to the matter of selecting a fare structure which will result in the least disturbance of traffic and at the same time provide the needed revenue in the most equitable manner. In our search for such a fare structure we have given consideration to applicant's plan, and have likewise given consideration to a number of forms of fare, such as a straight 6-cent cash fare, zone fares, and the existing 5-cent fare in combination with a 2-cent charge for a transfer.

"The Commission has concluded that the existing 5-cent fare, in combination with a 2-cent charge for a transfer, affords the greatest promise for the most favorable results to both the traveling public and the applicant carrier. Such a plan can be adopted upon an experimental basis and if it develops that this fare is not fulfilling the requirements, the entire matter can be reviewed and a record developed which will place the Commission in a better position to select a form of fare best suited to meet the needs of the public and provide a revenue sufficient to meet the cost of performing the service."

open for further investigation by the Commission". In fact, all of the proceedings involving the reasonableness of the fares of Market Street Railway Company, including the present proceeding, have been kept open and tentative rates established subject to readjustment from time to time as the results of experience may require. We shall again refer to this policy of fixing rates for public utilities. It must be obvious, however, that this policy of establishing tentative rates subject to readjustment as the results of experience may require, which policy is now generally followed by regulatory bodies, best serves the interests of the public as well as the utility, and assures the fairest results to both.

This record is voluminous on the subject of rates and fares. Mr. Hunter, the Commission's chief engineer, in his testimony relating to fares compared the company's fares with the average streetcar fares throughout the United States and said (Tr. 220) that San Francisco's average length of haul is among the lowest in the country, producing a higher fare per mile of travel. He also testified to the relationship of fares to service. Witness Mors, the Commission's transportation research engineer, testified to the company's rate history and in Commission's Exhibit No. 10 extensively reviewed the results of the company's operations from 1922 to 1942. This exhibit contains the company's rate history, an analysis of fare structures comparing the effect of the single cash fares with the so-called token fares, the effect of fare changes on operating revenue, and the revenue and passenger trends under various fare structures up to and including a portion of the year 1943. Mr. Cahill, manager of Public Utilities of San Francisco, testified (Tr. 83) that the San Francisco Public Utilities Commission strongly advocates a uniform 5-cent fare and universal transfer and (Tr. 99) that there should be no charge for transfers and that they would not be worth as much as one cent. With respect to the effect of fare increases of 1937-1938, witness Hunter (Tr. 11, 12 and exhibit 1) testified to the fare passengers and passenger revenues of Market Street and Municipal railways for the years 1933 to 1943. Witness Mors on the same subject testified re-

garding the effect upon operating revenue of a 2-cent transfer charge and the sale of tokens. (Tr. 115.) Mr. Kahn testified on the loss of his company's traffic to Municipal Railway after the company fare was increased above the 5-cent rate. The record is voluminous with respect to trends of earnings on the various fares and the effect of the fare changes on the company's net income.

This brief review of the record in so far as it deals with the company's fares and their effect on traffic, revenue, and service is by no means complete. It is a conclusive answer to the company's allegation it had no notice that the reasonableness of its rate was an issue. The petition on this point concludes with the following paragraph:

> "Even now, the company is not advised by any clear statement in the Commission's opinion on just what theory or basis the Commission premises its order reducing the company's rates. The opinion does not disclose whether the Commission has taken such action upon some theory that it might now undo a supposed mistake of the Commission itself made in 1937 and 1938 when it permitted the company to increase its rates from 5 cents to 7 cents; impose a rate reduction merely as a punishment to the company for failure to render a transportation service of some higher standard; or endeavors to fix just and reasonable rates for the future."

This observation we think is gratuitous. Decision No. 36739 is self-explanatory and states the basis on which the order reducing the rate from seven cents to six cents rests. There is no finding and no implication that we proceeded on a theory intending to "undo a supposed mistake" made in 1937 and 1938, when the rates were increased by stages from five to seven cents. Those increases, as heretofore pointed out, were specifically designated as an emergency increase and the three decisions in application No. 21115 leave no doubt that the authorized fares were experimental and subject to revision and adjustment depending upon developing conditions and cir-

cumstances. The one-cent rate reduction made in the decision here under consideration was not imposed "as a punishment to the company for failure to render a transportation service of some higher standard" but because of changed conditions and circumstances the Commission finds that a rate in excess of six cents is unreasonable and excessive. The decision is specific that the character and quality of the service rendered by the company does not justify a rate higher than six cents and that with such rate the company will be able to earn a fair return on the rate base, provided a reasonably adequate service is furnished and the necessary amount of available equipment is placed in operation.

Reference should here be made to the company's apparent protest in its argument on the petition for rehearing against the Commission's consideration of Exhibit No. 33.[41] That exhibit is referred to in the transcript under the des-

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[41] Mr. Smith (Tr. 354) said:

"Now, this matter of procedural due process of law also requires that the testimony, the evidence, upon which the Commission acts be taken at the hearing so that the other party may have an opportunity to controvert it and to criticize it.

"This record is most curious. The Commission's decision discloses, and affirmatively, that the Commission used an exhibit, Exhibit No. 33, that was never mentioned at the hearing, never made available to the other party."

And further:

"The Commission's decision speaks of a Commission's exhibit No. 33. I am reading from the first page of the opinion: 'Our staff made its studies and investigation in part prior to the hearing of May 10, and in part during the course of the proceeding, and introduced the results in the form of 18 exhibits.' Then there is a footnote and it lists various exhibits, including No. 33. Now, either this opinion misstates that upon which it acted, or I can't read the opinion, because it seems to me very clear that the opinion says that Exhibit No. 33 was introduced by the Commission, and it was one of the results of the Commission's studies and investigation of the case. Now, I would be very glad and very much relieved if I find that the Commission's staff did not introduce an exhibit of that kind.

"Commissioner Sachse: I think that situation with reference to Exhibit 33 is very clearly set forth on pages 341 and following and it really starts at page 340 and then runs through to 342."

ignation "To be furnished figures on Passengers and Car Hours" and pertains to Exhibit No. 22, introduced by company's witness Kahn, entitled "A study to determine the net income of the Company for the first six months of calendar years 1937, 1938 and 1939 if a 5¢ fare with free transfer had been in effect". In Exhibit No. 22 the number of passengers for the periods covered had been estimated by Mr. Kahn but the number of passengers actually carried by the company during the three periods was not shown in the exhibit. In the examination of company's witness Newton on September 15, 1943, exhibit 22 was under discussion and the question was asked of Mr. Newton whether the record contained the actual number of passengers carried and the actual number of car hours operated by the company in the three periods, as distinguished from the estimated figures in exhibit 22. The company agreed that these actual operating figures should be in the record and that they were to be given exhibit number 33.[42] We see no reason why

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[42] Tr. 340, *et seq.*:

"Commissioner Sachse: Have we now in the record the actual number of passengers that were carried on the Market Street lines in the three periods that are shown on the last page of that exhibit, namely, the first 6 months of 1937, first 6 months of 1938 and the first 6 months of 1939, and there also are in addition, the actual number of passengers that were carried, the actual number of car hours that were operated?

"Mr. Hunter: We have as to passengers and I think as to car hours.

"Commissioner Sachse: My point is in order to compare——

"Mr. Hunter: Yes.

"Commissioner Sachse: ——the actual figures with those estimates. We can have that, we should have those figures. They, of course, are available in the records by months, the first 6 months of 1937, the first 6 months of 1938 and the first 6 months of 1939, both passengers and car hours?

"Mr. Cassidy: May we be excused just a moment? We are checking.

"Commissioner Sachse: Certainly, Mr. Hunter, you do not have to look that up now, just so it may be understood, with the agreement of Mr. Appel, that that will be considered, that information will be considered part of the record.

"Mr. Cassidy: I would suggest, Mr. Commissioner, when those figures are available, that they be put in as an exhibit with a number reserved.

exhibit 33 should not have the Commission's consideration in this record.

The Commission Has Not Acted Arbitrarily or Capriciously in Reducing the Company's Rates from Seven Cents to Six Cents and Has Not Acted Without Any Substantial Evidence That the 7-Cent Rate Is Unreasonable.

The petition for rehearing states:

> "In so far as the Commission may have premised its order reducing rates upon the theory that rates should be no higher than the value of the service rendered, the Commission has acted without substantial or any evidence before it by which the value of the transportation service being rendered by the company can be measured."

This allegation is unfounded in fact. The extent, character and quality of the company's service at the time of the investigation is referred to in decision No. 36739 and findings are made. The record is replete with testimony on past and present service conditions and with comparative service statistics. There is nothing unusual or difficult about service measurements of street railway service. In the case before us no speculative or theoretical standards need be referred to. The record contains the company's actual operating performance for past years as reported in the company's sworn annual reports to this Commission and in the monthly reports filed with us. Such performance is shown in the operating expenses under the several accounts, in the number of cars operated, in the schedules and their performance, in the load factor statistics, in the maintenance records of roadbed, track and equipment, in the depreciation and renewal practices, in the observance of the company's paving obligations under its franchise require-

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"Commissioner Sachse: Very well.

"Mr. Cassidy: So that might actually be in the record.

"Mr. Appel: We will have no objection to that, to furnishing you whatever information you desire on that line.

"Commissioner Sachse: That information, then, would have the exhibit No. 33."

ments, and in other actual operating and service records. Such evidence in this case permits of ready and exact comparison of service and operating conditions and standards as they existed when the fare was five cents and under the increased fares subsequent to 1937, and under the 7-cent fare at this time. We find less and greatly inferior service in all respects under the 7-cent fare as compared with the service rendered under the 5-cent fare. We find that in comparison with the performance of the Municipal Railway the company's service is distinctly inferior. The Municipal road renders its superior service at a 5-cent fare while the charge for this company's inferior service is forty per cent higher, at seven cents.

In its petition the company refers to the satisfactory service furnished to San Francisco's war production plants and to the Navy. We gave consideration and recognition in our decision to the company's efforts in that respect.[43] Commander Jenkins, who testified on the service to Naval establishments, also stated that he was concerned primarily with "keeping the Navy establishments going and we leave the establishment of service to the general public up to the other agencies that have jurisdiction over it."

The company's allegations in its petition that "by picking and choosing bits of evidence revealed in the company's

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[43] Decision No. 36739 reads:

"No complaint can be made in regard to the company's service to establishments directly serving the war effort, such as shipyards and other war industries, and to Army and Navy concentration points. A letter of commendation from the Office of Defense Transportation is in evidence. Lieut. Commander Jenkins, U. S. N. R., Domestic Transportation Officer, 12th Naval District (former transportation research engineer of this Commission) testified that the company's service to Naval establishments has been satisfactory and that there has been cooperation with Navy headquarters. He stated that the Navy's transportation service requirements will greatly increase in the near future.

"We wish to put on record our conviction that all service requirements in furtherance of the war effort must have primary consideration of this company, as of all other utilities under our jurisdiction. Within the limits of our authority we are making, and shall continue to make, every effort to cooperate with the Army and Navy and with the appropriate federal agencies towards that end."

records of expenses incurred for the maintenance of its equipment and tracks, the Commission purports to find proof that the company has been derelict in its service duty" and that "neither the data referred to by the Commission in its opinion nor the testimony of the witness with respect thereto justifies the Commission's conclusion" are altogether unwarranted and the record is conclusive that the company has been and now is derelict in its service duty.

The petition refers to Section 13 of the Public Utilities Act [44] and alleges that we have acted without substantial or any evidence upon facts essential to accepted standards of the rate-making process. The record in this case is conclusive, and our decision, we think, sets forth in sufficient detail that the service, the equipment and the facilities of the company are not conducive to the promotion of the safety, health, comfort and convenience of its patrons, employees and the public, and are not adequate, efficient, just and reasonable, This has been true for a number of years past, and remains true at the present time. In this connection the petition alleges that no study was presented to indicate the probable financial results of the company's operation for the year 1943, or for any time in the future. The petition, and company counsel's argument as well, dwell at length upon the allegation that the Commission made its own assumptions of the traffic, the revenue, the expenses and net return for 1943, and for the future, on the various

[44] Section 13 of the Public Utilities Act reads:

"(a) All charges made, demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is hereby prohibited and declared unlawful.

"(b) Every public utility shall furnish, provide and maintain such service, instrumentalities, equipment and facilities as shall promote the safety, health, comfort and convenience of its patrons, employees and the public, and as shall be in all respects adequate, efficient, just and reasonable.

"(c) All rules and regulations made by a public utility affecting or pertaining to its charges or service to the public shall be just and reasonable."

rates of fare; viz., five cents, six cents and seven cents. The company's position as to what the Commission may do with the record before it in the exercise of its discretion and judgment was stated by counsel in his argument. (Tr. 403 et seq.) The Commission, according to counsel, can make arithmetical computations, but it cannot reach a deduction or conclusion that earnings or traffic or expenses for the entire year will be proportionate or disproportionate to the experience of a substantial portion of such year, or will be greater or smaller than in the preceding year, even though there be evidence of definite trends and extended actual experience. We cannot accept the company's limitations thus set upon the functions and duties of the Commission in a proceeding of this nature. In our consideration of testimony we are not confined to the operation of an adding or computing machine, nor does the law or common sense prevent our exercise of reasonable judgment on the basis of an entire and voluminous record. In rate cases, particularly when the proceeding is held open for further study and action, the Commission has on numerous occasions in the past established tentative rates subject to readjustment as the results of experience may require. This practice was followed in the 1937 and 1938 rate applications of this company, when several interim rates were ordered and put into effect, although the company had asked for different fares, and testimony had not been introduced on the specific fares ordered by the Commission.

This point came before the United States Supreme Court in *Clark's Ferry Bridge Company against Public Service Commission of Pennsylvania*, decided on February 5, 1934 (291 U. S. 227). That case involved the validity of an order of the Pennsylvania Commission reducing the rates of Clark's Ferry Bridge Company. That order, in part, prescribed "(1) A rate of 8 cents cash toll for all ordinary passenger automobiles and wagons now paying 10 cents". The order also provided, "That said Company file with this Commission monthly statements of income and operating expenses, showing the number of vehicles passing over its bridge in each class of traffic as contained in its tariff". One of the bases upon which it was claimed by the bridge company that the order of the Pennsylvania Commission

was unlawful was that the Commission undertook to forecast into the future what the traffic was going to be and that there were uncertainties and speculative elements in any such future estimate. Upon that matter Mr. Chief Justice Hughes said at page 241:

> "The final attack is on the form of the Commission's order. The Commission fixed the amount of the annual gross revenue and then prescribed a tentative schedule of rates. *Appellant says that it is obvious that no one can tell in advance how many vehicles of different tariff classifications will pass over the bridge in a year and what annual gross revenue will be produced by a given schedule of rates. But, as the prescribed rates are expressly stated to be tentative, there is no ground for assuming that the Commission will reject an application to make such changes in the schedule as experience may show to be necessary in order to produce the stipulated revenue.* There is nothing in the order which requires that the test period should be a year or any definite time. From the statements at the bar it appears that appellant has not put the tentative schedule in effect and has made no application to the Commission for a change in the schedule. If the allowance of gross revenue is adequate, as it has been found to be, there is no basis for complaint because of a schedule of rates which on application may be appropriately modified." (Emphasis supplied.)

The allegation that operating and financial results were in evidence only up to and including the month of March 1943 is incorrect. The stipulation entered into on the first day of the hearing, May 10, 1943, placed into the record the company's own monthly operating reports "from 1938 to date." (Tr. 19, 20.) Incorrect also and misleading is the allegation in the petition that the Commission's engineer did not testify to the financial effect of the 1938 rate increases. The record on that point in the transcript, pages 17 and 18, is as follows:

> "Commissioner Sachse: Mr. Hunter, while you are back on again now I would like to ask you one or two

questions. Taking sheet 1 of this exhibit and also at the same time, if you can, look at page 8. Is my conclusion correct that, after the fare increase in 1937 to the Market Street Railway the net revenue or operating income, notwithstanding the fare increase, disappears completely for the year 1938?

A. That is correct.

Q. In other words, before the fare increase in 1937 the operating income of the Company was $305,577; in 1938 after the fare increase, there was no operating income, but a deficit of $40,234?

A. That is correct.

Q. Then in the succeeding years, 1939, 1940, and 1941 the Company never recovered from these fare increases to even the lowest income, the lowest operating income, which was in 1937; in no year after the fare increase did the operating income reach again the operating income prior to the fare increase, with the exception of the year 1942?

A. That is correct.

Q. In other words, am I correct in concluding that the loss in passengers, in fare passengers, was so great up to 1942 that the fare increase was not able to overcome the loss in those passengers?

A. That is the way the results turned out.

Q. And, of course, in 1942, that being a war year, that situation changed?

A. Correct."

Mr. Hunter also testified to the "high riding habit" and the "average short haul", factors which make San Francisco an outstanding streetcar riding community. These factors assure a greater volume of business and revenue if the rate is reduced.

The Commission has based its conclusions on the operating and financial results of the fare increases and not on mere theory. The record shows the company's actual experience and we can see no reason why we should substitute mere theory when we have before us the uncontradicted facts.

Decision No. 36739 does not confiscate the company's property

The company alleges in the petition for rehearing that the sum of $7,950,000 does not represent the fair value of the company's operative property and cannot be used for rate-making purposes. Also, that a 6-cent fare will not produce a net operating income of about $500,000, or approximately six per cent on the base figure of $7,950,000 as found by the Commission.

We desire to discuss both allegations in some detail. The methods of determining a lawful and fair rate base by a regulating commission in cases of this nature has repeatedly been defined by the United States Supreme Court, and the principles we must follow to find fair value for rate-making purposes are not obscure. The rule we have applied in the decision in this proceeding was laid down by the United States Supreme Court in *Los Angeles Gas & Electric Corporation v. Railroad Commission of the State of California* (289 U. S. 287). Mr. Chief Justice Hughes delivered the opinion of the court and said at page 305:

> "As the property remains in the ownership of the complainant, the question is whether the complainant has been deprived of a fair return for the service rendered to the public in the use of the property. This Court has repeatedly held that the basis of calculation is the fair value of the property, that is, that what the complainant is entitled to demand, in order that it may have 'just compensation', is 'a fair return upon the reasonable value of the property at the time it is being used for the public'. (Footnote citing cases.) *In determining that basis, the criteria at hand for ascertaining market value, or what is called exchange value, are not commonly available. The property is not ordinarily the subject of barter and sale and, when rates themselves are in dispute, earnings produced by rates do not afford a standard for decision. The value of the property, or rate base, must be determined under these inescapable limitations.* And mindful of its distinctive function in the enforcement of constitutional rights, the

Court has refused to be bound by any artificial rule or formula which changed conditions might upset. We have said that the judicial ascertainment of value for the purpose of deciding whether rates are confiscatory 'is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts'." Citing cases. (Emphasis supplied.)

In the present case the property has recently twice been the subject of barter and was offered for sale, and its market value, or what is called exchange value, is available. The ascertainment of the present market or exchange value appears to have been exceptionally competent and authoritative. It was not based on opinion, testimony, or expert appraisal, but was made by the company's management and directors after extended studies and negotiations. The offer twice made, to sell all the operative property at the price of $7,950,000 was made, we must assume, in good faith since it was officially submitted to the City and County of San Francisco.[45]

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[45] The minutes of the company's directors' meeting of September 24, 1942, as shown in the transcript (p. 102) read in part as follows:

"Sale of the operative properties of Market Street Railway Company to the City and County of San Francisco. The President advised the Board that he has agreed with the Mayor and other City Officials, as well as the Board of Supervisors, to sell the operative properties of the Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000 cash, and that a charter amendment for the purpose of raising such sum by a revenue bond issue would be submitted to the qualified electors of the City and County of San Francisco at the next general election on November 3, 1942. The President stated further that the price mentioned had been agreed upon after lengthy negotiations extending over a period of about two years and is the best price obtainable from the City and County of San Francisco for the operative properties of the Company.

"Whereupon, on motion of Director Scott, duly seconded by Director Lilienthal, the following resolution was adopted:

"Resolved, that the actions of the President in negotiating the sale of and agreeing to sell the operative properties of the Market Street Railway Company to the City and County of San Francisco

An election was held, as agreed between the City and the Company, and the proposition to purchase the property at the price named failed to receive the required vote. That outcome, however, can have no bearing on the company's own measure of the market value of its own property. The deduction might be drawn that the price was higher than the majority of the voters were willing to pay.

In his argument on the value of the company's property, Mr. Smith points to the established rule that a utility valuation in a rate case cannot be based upon the capitalization of earnings, and he implies that the $7,950,000 figure was reached by that method. There is nothing in the record to indicate or suggest such a basis of valuation. The minutes of the directors' meeting, referred to above, clearly show how the market value was reached: "The President stated further that the price mentioned had been agreed upon after lengthy negotiations extending over a period of about two years and is the best price obtainable from the City and County of San Francisco for the operative properties of the Company." The board of directors, as has been shown, confirmed the judgment and conclusion of the company's president.

The petition for rehearing purports to reveal the steps by which we arrived at the conclusion that six cents is a reasonable fare. The recital of these alleged steps amounts to a complete misstatement of the plain language of our decision and the computations based upon such misstatements must necessarily lead to altogether erroneous and absurd numerical results. Such false results, in dollars of revenue, expense and not operating revenue, are shown in the petition and in greater detail in a series of four tables submitted by counsel to the Commission in the course of his argument. The company's misleading computations are

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for the sum of $7,950,000 cash be, and the same hereby are, ratified, approved and confirmed; and it is

"Further resolved, that the Officers of the Market Street Railway Company be and they are hereby authorized and directed to perform all necessary and proper acts in order to carry out and complete the sale of the operative properties of the Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000 cash."

ostensibly based on the findings contained in our decision, when as a matter of fact the plain language of that decision clearly substantiates our conclusion that a 6-cent fare, with reasonably efficient operation and service, will meet all operating expenses and in addition produce a return of approximately 6 per cent on the base figure of $7,950,000.

The company first (on page 7 of the petition) refers to the operating results for 1942, apparently taken from the table on page 24 of our decision. There is no dispute as to the correctness of the figures for that year, including the net return figure of $1,069,914. These figures, it is to be remembered, are from the company's own 1942 income statement furnished the Commission in the regular sworn annual report. The petition then continues with the following allegation:

> "The Commission concedes that $250,000 more should have been charged for depreciation, reducing the actual net revenue to $819,914. From this return the Company had to meet the interest and sinking fund requirements on its bonds, as the Commission previously had authorized it to do when approving its bond covenants, and had to meet also interest and retirement obligations on its unfunded debts that had accumulated from operating losses during earlier years."

This allegation is incorrect. The depreciation practices of the company are in evidence in this record in great detail. Consecutively for eight years prior to and including 1942 the company voluntarily charged $500,000 annually to depreciation and each year's net income is stated on that basis. There is no reason why the company's depreciation accounting should be changed by us for the year 1942 any more than for any other year. The fact that the company paid its interest and sinking fund charges in part out of its depreciation reserve, instead of making necessary replacements of depreciated equipment, is not relevant at this point.

Next, the petition complains of our estimate on the results of operations for the year 1943 under the 7-cent fare, with reference to traffic, revenue, expenses, and net return. The complaint is that we considered the actual operating figures

for eight months of the year and that we made assumptions for the remaining four months. On that account our conclusion that with the 7-cent fare continued in effect and with the quantities of service continuing and the number of cars operating as theretofore, the gross revenue for the full year 1943 would be $8,700,000, the expenses $7,940,000 and the net return $760,000, and the rate of return 9.6 per cent is alleged to be erroneous and contrary to due process. We have stated above the basis of our conclusions. It would be very simple to meet the test of fairness suggested by company counsel in his argument on rehearing [46] if our 1943 estimates were checked against the actual operating performance according to the company's own records and filed with this Commission under our order in this continuing rate proceeding. Counsel refused, however, to stipulate to such a check and in order to avoid a possible technical pitfall in the law on evidence we will not argue this point. We are confident the Commission kept within the limits of its discretionary judgment in concluding that the remaining months of 1943, with no change of fare and no material change in service, would follow the established trend as evidenced in the record.

The petition next purports to show the "assumptions" made by us as to the results of the operation for the year 1943, "and presumably for the future," under a 5-cent fare. The petition says "It is found that such a fare would produce a net loss of $1,153,000 per year." The petition ignores the qualified and all-important language in our decision "without any allowance whatever for increased traffic." [47]

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[46] Mr. Smith said (Tr. 346): "Now, this matter of procedural due process of law is a very simple matter. Lawyers often use, though, many complicated words to express simple things. What we mean is fair play."

[47] The decision, page 31, reads as follows:

"The fixing of a five-cent fare on a twelve months' basis, *without any allowance whatever for increased traffic*, and including in operating expenses $500,000 for depreciation, would result in a deficit of about $1,153,000. On the basis of the record the indications are that with a five cent fare a 25% to 30% increase in traffic would be required to produce an income, after allowing for increased operating costs, to meet all expenses, including depreciation and taxes, and leave the company with approximately 5% return on the $7,950,000

The net loss of $1,153,000 per year, without considering the qualifying language in the decision, is obviously a mere mathematical calculation and reached by applying a 5-cent fare to the identical number of 7-cent fare passengers, i.e., a reduction of two cents for each of the 7-cent fare passengers. On this basis the petition concludes: "Hence, having found that the net profit of $760,000 expected at a seven-cent fare would be converted into a net loss of $1,153,000 if a five-cent fare were in effect, the sum of these figures, or $1,913,000, is the amount of the expected reduction in gross revenue." The Commission, it must be clear, made no such assumptions and reached no such conclusions.

The petition, continuing on its erroneous basis, then presumes to explain "The last step taken by the Commission as to the effect of the application of a six-cent fare." Decision No. 36739, page 32, reads as follows:

> "We expect the company to make every reasonable effort to improve the present unsatisfactory and inadequate service and to put all available equipment into operation. With a six-cent fare it is our expectation, based on the evidence available from the record and from the company's past and present experience, that an annual revenue of approximately $8,500,000 will be produced. Operating expenses, including taxes and $750,000 for depreciation, we estimate, will amount to about $8,000,000, leaving a net operating income of about $500,000, corresponding to an approximate rate of return of 6% on the base figure of $7,950,000. Such a return would be more than adequate under existing conditions."

The company in its petition, however, comes to a different conclusion. It says "If a reduction of 2 cents in the Com-

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base figure. Such a result, with efficient management and the proper use of all available equipment and plant, might reasonably be brought about. An increased use by the public of all mass transportation facilities must definitely be expected in San Francisco, not only because of further reduction in the gasoline allowance and the declining number of automobiles, but also in view of the certain increase of direct and indirect war activities in this area." (Emphasis supplied.)

pany's existing seven-cent fare would result in a gross revenue decrease of $1,913,000, as the Commission estimates, it is evident that a reduction of one cent would operate to reduce gross revenue by fully one half that amount, for there could not be a greater stimulation of traffic at a six-cent fare than at a five-cent fare." Above it was shown that in its allegation of what the five-cent fare would accomplish, the Commission's qualifying language as to what a reasonable increase in traffic would do had been entirely ignored by the company and no allowance whatever for increased traffic was made in the company's estimate of $1,913,000 reduction in gross revenue. In its estimate for the 6-cent fare, and coming to the conclusion that a deficit of at least $256,500 would be suffered, the petition reasons that "there could not be a greater stimulation of traffic at a 6-cent fare than at a 5-cent fare." Having made *no allowance for any* stimulation of traffic at a 5-cent fare, the company follows the same erroneous assumption as to the 6-cent fare.

A casual inspection of decision No. 36739 shows that the Commission concluded with the 6-cent fare under reasonably satisfactory and adequate service, and with the operation of adequate available equipment, the next 12-months' annual gross revenue would be $8,500,000 as compared with the 1943 revenue under the 7-cent fare of $8,700,000, a reduction of $200,000. For the future 12-months' period under the 6-cent fare the Commission made its allowance of $8,000,000 of operating expenses compared with the 1943 operating expenses under the 7-cent fare of $7,940,000, an increased allowance for operating expenses of $60,000. Deducting the operating expenses from the operating revenue, under the future 6-cent fare, leaves a 12-month net operating income of $500,000, which we concluded would be the approximate amount available for return, corresponding to a rate of return of about 6 per cent on the base figure of $7,950,000. Such a rate of return, we concluded, would be more than adequate under existing conditions.

Conclusion.

The Supreme Court of the United States has just rendered another decision which supports our views of the

policy and methods we have followed throughout these proceedings. We refer to the case of *Federal Power Commission* v. *Hope Natural Gas Company*, decided by the United States Supreme Court as recently as January 3, 1944. This case involved the legality of an order of the Federal Power Commission reducing the rates charged for natural gas by Hope Natural Gas Company. It is unnecessary here to discuss that case at length. We do desire, however, to quote portions of that decision which are particularly pertinent here. In upholding the order of the Federal Power Commission Mr. Justice Douglas, in stating the opinion of the Court, says:

> "When we sustained the constitutionality of the Natural Gas Act in the *Natural Gas Pipeline Co.* case, we stated that the 'authority of Congress to regulate the prices of commodities in interstate commerce is at least as great under the Fifth Amendment as is that of the States under the Fourteenth to regulate the prices of commodities in intrastate commerce.' 315 U. S. p. 582. Rate-making is indeed but one species of price-fixing. *Munn* v. *Illinois*, 94 U. S. 113, 134. The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. *But the fact that the value is reduced does not mean that the regulation is invalid. Block* v. *Hirsh*, 256 U. S. 135, 155-57; *Nebbia v. New York*, 291 U. S. 502, 523-539 and cases cited. *It does, however, indicate that 'fair value' is the end product of the process of rate-making not the starting point as the Circuit Court of Appeals held. The heart of the matter is that rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated.*'" (Footnote 9 omitted.) (Emphasis supplied.)

In the case before us the market or exchange value of the company's operative property was not reduced by any lower rates prescribed by this Commission. On the contrary, the Commission in the 1937-1938 proceedings hereto-

fore referred to substantially increased the company's rates. That increase, by stages from five to seven cents, finally amounted to a raise of 40 per cent. Notwithstanding the increase the company's net revenues fell below the previous net revenue from the 5-cent fare in each of the subsequent years 1938, 1939, 1940 and 1941 when the higher fare was in effect. The record is conclusive that the value of the company's property declined because of the operation of economic forces and, particularly, by reason of the effective competition of the Municipal Railway which furnished a better service at the lower rate.

The decision of the United States Supreme Court in the case referred to continues:

> "We held in *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' *Id.*, p. 586. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. *Id.*, p. 586. Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. Cf. *Los Angeles Gas & Electric Corp.* v. *Railroad Commission,* 289 U. S. 287, 304-305, 314; *West Ohio Gas Co.* v. *Commission* (No. 1) 294 U. S. 63, 70; *West* v. *Chesapeake & Potomac Tel. Co.*, 295 U. S. 662, 692-693 (dissenting opinion). *It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.* The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and

unreasonable in its consequences. Cf. *Railroad Commission* v. *Cumberland Tel. & T. Co.*, 212 U. S. 414; *Lindheimer* v. *Illinois Tel. Co., supra*, pp. 164, 169; *Railroad Commission* v. *Pacific Gas & E. Co.*, 302 U. S. 388, 401." (Emphasis supplied.)

Later in the same opinion the Court says:

"It is suggested that the Commission has failed to perform its duty under the Act in that it has not allowed a return for gas production that will be enough to induce private enterprise to perform completely and efficiently its functions for the public. The Commission, however, was not oblivious of those matters. It considered them. It allowed, for example, delay rentals and exploration and development costs in operating expenses. No serious attempt has been made here to show that they are inadequate. *We certainly cannot say that they are, unless we are to substitute our opinions for the expert judgment of the administrators to whom Congress entrusted the decision. Moreover, if in light of experience they turn out to be inadequate for development of new sources of supply, the doors of the Commission are open for increased allowances. This is not an order for all time. The Act contains machinery for obtaining rate adjustments.*" (Emphasis supplied.)

This latest decision of the Supreme Court of the United States, we are confident, supports our decision No. 36739 in these proceedings. We have found that a 6-cent fare for Market Street Railway Company is just and reasonable and that any fare in excess of six cents is unjust and unreasonable. If, in the light of experience, the 6-cent fare should prove to be unreasonable under all the circumstances present in the operation of the company's street railway system, the Public Utilities Act contains the machinery for obtaining rate adjustments.

Our decision makes provision for the filing of monthly operating and service reports and we shall keep ourselves continuously informed of the traffic and revenue results

from the 6-cent fare and also of all other pertinent operating and service facts. If, in the light of the actual experience, it appears that the fare should be changed we shall, on our own initiative, take appropriate action.

We conclude that the petition of Market Street Railway Company for rehearing of decision No. 36739 should be denied.

Order Denying Rehearing

Market Street Railway Company having filed a petition for a rehearing of decision No 36739 in the above proceeding, the Commission having granted and heard oral argument on said petition, and being of the opinion that rehearing should be denied, It Is Ordered as follows:

1. That the petition of Market Street Railway Company for a rehearing of decision No. 36739 be and it is hereby denied.

2. That the effective date of decision No. 36739 be and it is hereby extended to February 11, 1944.

Dated at San Francisco, California, January 12, 1944.

RICHARD SACHSE,
FRANCK R. HAVENNER,
FRANK W. CLARK,
Commissioners.

Certified as a true copy. R. J. Pajalich, Asst. Secretary, Railroad Commission of the State of California. (Seal.)

EXHIBIT 3

Filed Jul 1, 1944. A. V. Haskell, Clerk. By —— ——, S. F. Deputy; S. F. No. 16988.

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA, IN BANK

MARKET STREET RAILWAY COMPANY, Petitioner,

vs.

RAILROAD COMMISSION OF THE STATE OF CALIFORNIA and Franck R. Havenner, C. C. Baker, Justus F. Craemer, Richard Sachse and Frank W. Clark, the members of and constituting The Railroad Commission of the State of California, Respondents.

The Railroad Commission on its own motion ordered an investigation into the reasonableness of the rates and the sufficiency and adequacy of the service rendered by Market Street Railway Company in San Francisco. After hearings the commission filed its opinion and order reducing the rate of base cash fare for transportation of passengers in the city from seven to six cents. The company petitioned for a rehearing which was denied. The matter is here on its petition for a review pursuant to section 67 of the Public Utilities Act.

The petitioner attacks the proceedings and order as a deprivation of orderly due process, and as a confiscation of its property.

I

On the first, the procedural question, the company claims that it was denied due process by a failure of notice that it was being charged with the maintenance of unreasonable rates; that the issue of unreasonableness of rates was not framed during the course of the hearing; that the commission introduced no evidence of unreasonableness of the prevailing rate, and that the company was not afforded an opportunity to present evidence on the issue.

The petitioner does not claim that it did not receive a copy of the "Order Instituting Investigation", which was

mailed to it. That order notified the company that "the commission, believing that public interest demands an inquiry into the reasonableness of the rates, as well as the sufficiency and adequacy of the service rendered by the Market Street Railway Company", would institute an investigation upon its own motion "into the reasonableness of the rates, charges, classifications, rules and regulations" of the company, "and also into the reasonableness, sufficiency and adequacy of the operations, service and facilities of said company." The 10th day of May, 1943, was set as the time for the commencement of the public hearings. Notice of the time of hearing was also sent to other public utilities, and public and civic bodies and officers, including the California Street Cable Railroad Co., the Mayor and the Board of Supervisors of the City and County of San Francisco, the Department of Public Works, the Board of Public Utilities, the City Attorney, the San Francisco Chamber of Commerce, the Office of Defense Transportation, and others. Hearings were conducted on May 10, July 15, and September 15, 1943. Thirty-three exhibits were introduced, consisting of reports and documents bearing on income and revenues, studies and reports of value, analyses of profit and loss accounts, operative expenses, statistical studies in passenger revenue and car and bus hours, as well as studies in operative equipment, traffic checks, results of operation, charges and revisions in operative practices, and comparative rate and operation analyses of Market Street Railway and the Municipal Railway of San Francisco. Certain voluminous annual and monthly reports in addition were by stipulation deemed to be before the commission. The oral evidence is contained in three volumes of transcribed testimony. Witnesses were produced by the commission, by the city and by the company. J. G. Hunter, produced by the commission, the first witness to testify, gave a resume of the matters for investigation, which included "operating expenses, taxes, depreciation, studies on rate base figures, the estimated operating results that would obtain under different fare structures." Comparative balance sheets, charges and reports were introduced dealing with these subjects. Comparisons were

made between appraisals based on book value and on historical cost. Testimony on the state of the physical properties, on employment conditions, on available manpower, on adequacy of the service and facilities, on the possibility of interchange of facilities and a universal transfer system, on the company's franchise obligations in roadbed upkeep, and on elements to be considered in evaluating service, was also received. Mr. Samuel Kahn, who is president and general manager of the company and an engineer and expert in utility management, and Mr. Leonard V. Newton, vice-president of the company and engineer in charge of operations, testified on behalf of the company. On direct and cross-examination Mr. Kahn testified and presented exhibits illustrating his opinion of the effect of various rate structures. Mr. Newton's testimony was confined mainly to operations and employment conditions.

Thus, the company had the required notice of hearing on the question of reasonableness of the rates and full opportunity at the hearings to present any further evidence on the rate issue, had it chosen to do so. The notice and the course of the hearings were adequate to inform the company that the reasonableness of the present rate was under investigation. The discussion on this phase of the review may be concluded by stating that the various studies, reports and other statistical data, including the record in prior rate proceedings, together with the exhaustive investigation into the present state of the properties and the adequacy and value of the service, must be deemed to have had a direct bearing on the rate issue. The fact that the financial and rate base studies were required to be produced by the commission as a part of the record was sufficient to give to the company ample warning that the commission was seriously proceeding into an investigation of the reasonableness of the existing rate. In fact Mr. Kahn's testimony clearly indicated that he so understood the purpose of the inquiry. The statement of counsel that the elements of fair play were so lacking in the proceedings as to call for a conclusion that orderly due process was not observed is not supported by the record. The company had the opportunity to supplement or explain the reports and data

introduced in evidence. The commission also accorded the opportunity for argument on the petition for rehearing, but no supplement or explanation of the submitted data was referred to on the argument on rehearing. At that time the petitioner merely contended that a rehearing should be granted in order to conduct further studies on the estimates of future revenues, expenses and net return under various rates, as well as valuation studies to supply evidence of different rate bases, including reproduction cost, different from those on which the commission placed its estimate of a fair return from operations under the reduced rate. Under these circumstances the comment of the court in Railroad Commission of California v. Pacific Gas & Elec. Co., 302 U. S. 388, at page 393, is appropriate here: "As we have seen, the respondent [petitioner] was heard, the Commission received the testimony of respondent's witnesses, its exhibits and argument. There is nothing whatever to show that the hearing was not conducted fairly." The petitioner's further demands are more properly addressed to the matter of reasonableness in relation to due process when we come to consider the second phase of this review, namely, the issue of confiscation.

II

The opinion of the commission gives the essential background. The year 1852 saw the first omnibus service in San Francisco; 1860 the first street railway; and 1873 the first cable line. The cable was more suited to the hilly terrain and some of the horsecar lines were converted to the cable method of operation. In 1893 Market Street Railway Company was incorporated and took over eleven of seventeen independent street car lines.

By city charter amendments ratified by the electors in 1902, provisions were enacted for municipal acquisition of public utilities. (Stats. 1903, pp. 586 et seq.) Privately owned street railways were permitted to hold franchises for not to exceed 25 years, whereupon tracks and overhead construction should revert to the city without cost.

In 1902 United Railroads of San Francisco was incorporated. It succeeded to the properties of Market Street

Railway Company and five additional lines. The earthquake and fire of 1906 caused heavy losses and a large reconstruction program ensued.

In 1912 the first municipal line was placed in operation. Municipal railway expansion proceeded rapidly in order to serve the traffic during the Panama Pacific International Exposition in 1915. The city built lines of extension parallel with some of the Market Street Railway lines.

United Railroads became unable to pay the interest on its bonded indebtedness and in 1921 its properties were acquired by the bondholders under foreclosure sale and were in turn sold to Market Street Railway Company. The 25 year franchise limitation was not enforced: Pursuant to section 131 of the city charter (Stats. 1931, p. 3052), the company surrendered its franchises and was granted a 25 year permit to continue operations subject to the right of the city to acquire the properties upon paying the fair value of the operative properties exclusive of going concern value or other intangible elements. In 1925 the company began placing motor buses in operation and by December 1942 it had 125 buses in service.

The competitive factor induced by the continuing expansion of the municipal railway system became a constantly increasing threat to the operational and financial integrity of the company. The Market Street Railway Company came under the jurisdiction of the Railroad Commission, while the municipal lines remained subject to the regulation and supervision of the city. The municipality retained a five cent fare even though the system was operated with a deficit. Market Street Railway's original franchises included a five cent fare clause.

In 1937 Market Street Railway applied to the Railroad Commission for an increase of the fare to seven cents. The application was granted to the extent of permitting a two-cent transfer charge. At that time the company was admittedly not seeking the increase on the basis of a fair return on its investment, but sought merely to meet $1,000,000 additional annual operating expense due to increased taxes and labor costs. (Dec. #29889, 40 C. R. C. 525.) In its opinion in that proceeding the commission said: "It is

clear from this record that operation under any reasonable fare structure will not in the near future yield a revenue sufficient to provide a full return on any reasonable rate base of applicant's property, so long as the competing Municipal lines are operating on a 5-cent fare. For that reason this record does not deal with the matter of establishing a rate base for this property. In fact, the only reference to valuation in this record is that which is contained in the application to the effect that a valuation made [in a report filed with the supervisors in 1929] by the late M. M. O'Shaughnessy, former City Engineer of San Francisco, shows that the present fair value of applicants property is at least $24,000,000." Its decision (ibid, p. 532) discloses that the president of the company was of the opinion "that experience alone could tell what results would obtain if the proposed fare structures were put into effect."

In 1938 the company made a supplemental application for an increase to a seven-cent fare on a showing that revenues had declined and that further increased operating expenses were imminent due to higher labor costs. The commission granted the application to the extent of permitting a seven cent fare, four tokens for 25 cents. Again the commission noted that the company was not seeking the new rate on the basis of a fair return on its investment. (Dec. #30849, 41 C. R. C. 349, 351.)

The City of San Francisco granted franchises to bus companies for operation on a ten cent fare in direct competition with the company, but refrained from granting any such franchises which would compete with the municipal lines. The company attempted to effect economies by installing one-man operation in its electrically operated cars, but that practice was discontinued when the Federal Courts upheld a San Francisco city ordinance forbidding one-man operation of street cars. (San Francisco v. Market Street Railway Co., 98 Fed. 2d 628, 305 U. S. 657; 306 U. S. 667.) The company had attempted to abandon unprofitable lines, but had been unable to obtain permission from the city to do so.

Consequently in the same year (1938) the company made a second supplemental application for a straight seven cent

basic fare. The showing was that as a result of the increase in fares in a twelve month period more than 10,000,000 passengers had been diverted to the municipal lines, and the company was operating at a loss. San Francisco is a city with what is termed a "high riding habit" and a large percentage of the lost traffic consisted of short-haul riders who declined to pay the seven cent fare. In that proceeding the commission concluded that the company was entitled to relief to prevent a collapse or partial collapse of its service, and, accepting the company's estimate that revenues could be increased only by a straight seven cent fare, it granted the petition conditionally. It required the company forthwith to petition the board of supervisors of the city for permission to abandon operation on specified lines and for such form of relief as might be necessary to eliminate "jitney" competition. The company complied with the requirements and on December 12, 1938, the board of supervisors denied the requests. Thereupon, on December 27, 1938, the commission ordered the new schedule based on a straight seven cent fare effective January 1, 1939.

The straight seven cent basic fare has continued until the present time. The hoped for results, however, did not immediately materialize, even with the stimulation afforded by the holding of the Golden Gate International Exposition in 1939-1940. Compared with the year 1936, the last year under the five cent fare, the 1941 traffic and revenue reached the lowest ebb, showing a falling off of 64,056,000, or 42 per cent, in revenue passengers, and $1,426,282, or 19 per cent, in passenger revenue. The figures show a decline of 39 per cent in revenue as compared to the maximum revenue year of 1925. The state of the operative properties and the adequacy of the service continued to decline. The company became unable to discharge its franchise obligations for roadbed maintenance and the city was attempting to collect $1,691,162.76 claimed as arrears.

After the entry of this country into the present world war in 1941, and upon the stepped-up production of war materials, an abnormal increase in traffic occurred result-

ing in increased revenue, accompanied, however, by a further marked deterioration in the operative properties and in the service to the public.

The commission examined the condition of the properties and the adequacy of the service in relation to the prevailing rates for transportation. It found evidence of long-time neglect, deterioration, mismanagement, indifference to urgent public need, and other causes productive of poor service, not all of which were chargeable to the war. The company refused to lease idle equipment to the municipality although the latter had sought to put it into service on its own lines after the Office of Defense Transportation had denied it priority rights for new equipment because of the existing condition of idleness of rolling stock in San Francisco, none of which was attributable to the city. The company was unsuccessful in retaining or drawing its share of the available manpower, which was being diverted to the Municipal Railway. Undeniably there is evidence of "deplorable condition of track, of deferred maintenance, unfulfilled street paving obligations, obsolescence of street car equipment, and the failure of the company to replace, during pre-war years, uneconomical and outdated facilities by modern, more efficient, and more profitable means of mass transportation", conditions which had grown progressively worse over a period of years antedating the commencement of the war. Service, with the exception of that to establishments directly engaged in the war effort, such as shipyards and army and navy concentration points, steadily declined in quality and adequacy. The commission stated that an analysis of the company's finances showed that over a period of years the company had diverted to payment of indebtedness funds urgently required for proper maintenance and for the replacement of depreciated property.

The record makes it apparent, and the commission recognized, that in the past competition was the factor which prevented the company from reaping financial benefit from any rate structure; that heretofore the private automobile has given the railways competition; that that source of competition is partially eliminated during the period of

rubber and gasoline shortage; that the increased traffic due to war activities will not last, and that as soon as transportation conditions return to normal the company will again be handicapped by a seven cent fare against the competition of the Municipal Railway and the automobile; and that under any rate structure the condition of the company will grow even worse than at the former low level unless the service is greatly improved. It is also disclosed that while prior to the war the five cent fare produced a greater gross and net annual revenue than any fare in excess of five cents, a five cent fare structure will not realize any net return to the company under a competitive system of operation.

Compared with Market Street Railway, the Municipal Railway under a five cent fare has gained in quality of service and equipment, and in financial returns. As with Market Street Railway, however, the Muncipal Railway's increase in financial returns began with the abnormal increase in traffic.

Attempts had been made to have the city of San Francisco acquire the Market Street Railway. Transportation surveys and property appraisals had been prepared and negotiations carried on over a long period of years. At the general election of November 3, 1942, the electorate of San Francisco rejected a proposed revenue bond issue to raise $7,950,000, the price theretofore settled upon at which the company would sell its properties to the city. A similar proposition at the same figure was again submitted and again rejected at a special election held April 20, 1943.[48]

The commission rejected the company's book figures of cost and depreciation and selected the offered price, $7,950,000, as the value of the utility and rate base for the purpose of computing the return to the company under various rate structures. It concluded that operation under a six cent fare, after deduction from gross passenger revenue of operating expenses, depreciation and taxes, would pro-

[48] Since this review proceeding was commenced and on April 16, 1944, the electorate of the city voted favorably on a proposition to acquire the operative properties of the company on a self-liquidating plan for $7,500,000.

duce a net return of slightly more than six per cent on the rate base of $7,950,000. It computed that a seven cent fare, allowing an increase in operating expenses to $7,940,000, including $750,000 for depreciation and $590,000 for taxes, would yield annual net operating revenues of $760,000, a return of 9.6 per cent on the rate base. Figuring the return from a seven cent fare on a depreciation allowance of $500,000, which is the amount the company had been charging off annually, the percentage would be 12.7. The commission found both these rates of return excessive and unjustified by the present service. Its computation under a five cent fare, with a depreciation allowance of $500,000, indicated a deficit of $1,153,000. On a six cent basic fare it estimated annual gross revenue at $8,500,000, operating expenses, depreciation and taxes at $8,000,000, leaving a net operating income of $500,000, slightly more than six per cent on the base figure of $7,950,000, which return it found to be reasonable. It said that consideration of service alone and of the value of service to the patron would justify the fixing of a five cent fare; but it determined that a six cent fare was a just, fair and reasonable rate, provided every possible and reasonable effort promptly be made by the company to furnish an improved service, and that a fare in excess of six cents was unjust and unreasonable.

No contention is urged that a six per cent return on the investment is not adequate, under present conditions, to attract capital and keep a utility in a solvent condition. The question is whether the record clearly establishes that the selection of the figure of $7,950,000 as the rate base will result in confiscation of the company's property.

The commission rejected all other figures and selected the offered price as that most truly representative of the value of the company's properties. It said that "the only available indication in this record of the present value of the company's properties used and useful in the public service is the resolution of the company's Board of Directors, passed on March 25, 1943. The resolution (Exhibit 9) reads as follows:

> "Sale of the operative properties of the Market Street Railway Company to the City and County of San

Francisco. The President advised the Board that he had agreed with the Mayor and other city officials, as well as the Board of Supervisors, to sell the operative properties of Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000.00 cash, which was the same amount agreed upon for the sale of the operative properties when a charter amendment for the purpose of raising such sum by a revenue bond issue was submitted to and rejected by the qualified electors of the City and County of San Francisco at the general election on November 3rd, 1942. The President stated further that a similar charter amendment, with several changes therein, for the purpose of raising the sum agreed upon for the sale of the operative properties of the Market Street Railway Company to the City and County of San Francisco by a revenue bond issue would be submitted to the qualified electors of the City and County of San Francisco at a special election to be held on April 20, 1943. The President also stated that the price mentioned is the amount that had been agreed upon for the purchase by the City and County of San Francisco of the operative properties of the company after negotiations in respect thereto which covered a considerable period of time, and, as previously mentioned, is the best price obtainable therefor.

"Whereupon, on Motion of Director Fay, duly seconded by Director Scott, the following resolution was adopted.

"Resolved, that the actions of the President in negotiating the sale of and agreeing to sell the operative properties of the Market Street Railway Company to the City and County of San Francisco for the sum of $7,950,000.00 cash be, and the same hereby are, ratified, approved and confirmed; and it is

"Further Resolved, that the officers of the Market Street Railway Company be and they are hereby authorized and directed to perform all necessary and proper acts in order to carry out and complete the sale of the operative properties of the Market Street Rail-

way to the City and County of San Francisco for the sum of $7,950,000 cash."

The commission adopted the price stated in the offer as the "present fair market value", without the necessity of expressing an "opinion on the reasonableness of the figure of $7,950,000 as an exact measure of the present fair value of the company's operative property in its present depreciated physical and service condition, with its past earning record and its prospective future under the competitive transportation situation obtaining in San Francisco." The petitioner contends that the ultimate figure adopted by the principals for the sale of the property to the city and therefore by the commission as the present fair market value was based on a capitalization of earnings; that the commission should have proceeded on a consideration of depreciated reproduction cost and historical cost, in accord with the holding of the Supreme Court of the United States in Smyth v. Ames, 169 U. S. 466, and other cases.

In Smyth v. Ames, after stating that the basis of all calculations as to the reasonableness of rates must be the fair value of the property being used for the convenience of the public, the Supreme Court proceeded to lay down the essential matters for consideration in ascertaining that value. (p. 546.) "And in order to ascertain that value the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth."

Subsequent decisions emphasized the necessity for finding fair value by weighing all the elements prescribed in Smyth v. Ames. Notably in Minnesota Rate Cases, 230 U. S. 352, at 434, the Supreme Court said that there must be a "reasonable judgment having its basis in a proper consideration of all relevant facts", repeating the language quoted from Smyth v. Ames. The emphasis progressed to the extent that in many cases, if one factor or element, particularly that of reproduction cost new, had not received consideration in arriving at "present fair value", it was determined that the constitutional due process requirement had been violated. (Southwestern Bell Tel. Co. v. Public Service Com., 262 U. S. 276; Bluefield etc. Co. v. Public Service Com., 262 U. S. 679; McCardle v. Indianapolis Water Co., 272 U. S. 400; United Railways v. West, 280 U. S. 234; cf. Pacific Gas Co. v. San Francisco, 265 U. S. 403; Los Angeles Gas Co. v. Railroad Commission, 289 U. S. 287; Railroad Comm. of Calif. v. Pacific Gas & Elec. Co., 302 U. S. 388.) Thus due process was deemed not to have been observed if it was shown that the regulatory body, in evaluating the plant or operative properties for rate purposes, had not considered depreciated reproduction cost as well as book cost, actual (sometimes called original or historical) cost, capitalization, etc. Since calculations under each formula led to widely different results it became apparent that in Smyth v. Ames rule had provided itself unworkable. Criticisms of it are found in the dissenting and concurring opinions in Southwestern Bell Tel. Co. v. Public Service Com., 262 U. S. 276, 289; Pacific Gas Co. v. San Francisco, 265 U. S. 403, 416; McCardle v. Indianapolis Water Co., 272 U. S. 400, 421; United Railways v. West, 280 U. S. 234, 255; and West v. C. & P. Tel. Co., 295 U. S. 662, 680. In the Southwestern Bell Tel. Co. case, Justice Brandeis (Justice Holmes concurring with him), disagreed with the majority view that the commission must consider reproduction cost new under the slogan "Estimates for tomorrow cannot ignore prices of today", and advocated the prudent investment theory.

In Georgia Ry. v. R. R. Comm., 262 U. S. 625, decided less than three weeks later, Justice Brandeis writing the

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majority opinion distinguished the Southwestern Bell Tel. Co. case. The court decided that the commission was not bound to slavish adherence to reproduction cost new in a case where the evidence showed that it gave consideration to that element, the dissenters seeking to apply the Southwestern Bell decision. On the same day the court also decided Bluefield Water Works v. Public Service Comm., 262 U. S. 679, wherein reproduction costs had not received consideration and the court reversed, following the Southwestern Bell case, Justice Brandeis disagreeing with the grounds of reversal.

In the case of McCardle v. Indianapolis Water Co., 272 U. S. 400, 408, the court required a further step, namely, that the future as well as the present must be regarded; that present value could not be determined without an honest and intelligent forecast as to probable price and wage levels, probable yield over operating expenses, etc., during a reasonable period in the immediate future.

In 1933 the Supreme Court obviously began to anticipate a departure from adherence to Smyth v. Ames. In the case of Los Angeles Gas Co. v. Railroad Comm., 289 U. S. 287, the court in effect upheld the California commission which, in making a rate reduction order, had rejected reproduction cost figures as "too uncertain and hypothetical to enter into a rate base figure." The court relied on the Minnesota Rate Cases for the theory that the cost-of-reproduction method did not justify the acceptance of results which depended upon mere conjecture. It pointed out the necessity of distinguishing between the legislative and judicial functions; that it is the appropriate task of the commission to determine the value of the property affected by the rates it fixed, and that of the court, in deciding the question of confiscation, not to lay down a formula, much less to prescribe an arbitrary allowance, but to examine the result of the legislative action in order to determine whether its total effect is to deny to the owner of the property a fair return for its use. It said: (p. 304) "We do not sit as a board of revision, but to enforce constitutional rights. San Diego Land & Town Co. v. Jasper, 189 U. S. 439, 446. The legislative discretion implied in the rate making power necessarily extends to the

entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself. We are not concerned with either, so long as constitutional limitations are not transgressed. When the legislative method is disclosed, it may have a definite bearing upon the validity of the result reached, but the judicial function does not go beyond the decision of the constitutional question. That question is whether the rates as fixed are confiscatory. And upon that question the complainant has the burden of proof and the Court may not interfere with the exercise of the State's authority unless confiscation is clearly established."

In April 1934, the Supreme Court upheld the commission's order prescribing rates for telephone service in the case of Lindheimer v. Illinois Tel. Co., 292 U. S. 151. It rejected the company's claim that the rates were grossly confiscatory because not based on estimates of original or book cost and reproduction cost new; for, to recognize the claim, it stated, would be to sanction "a large increase over the rates which have enabled it to operate with outstanding success. Elaborate calculations which are at war with realities are of no avail."

West Ohio Gas Co. v. Commission, 294 U. S. 63 (January 1935), reiterated the restricted function of the court declared in Los Angeles Gas Co. v. Railroad Comm. of California, 289 U. S. 287, saying (p. 70), "Our inquiry in rate cases coming here from the state courts is whether the action of the state officials in the totality of its consequences is consistent with the enjoyment by the regulated utility of a revenue something higher than the line of confiscation. If this level is attained, and attained with suitable opportunity through evidence and argument (Southern Ry. Co. v. Virginia, 290 U. S. 190) to challenge the result, there is no denial of due process, though the proceeding is shot through with irregularity or error."

Nevertheless, less than six months later, in West v. C. & P. Telephone Co., 295 U. S. 662 (June 1935), the court affirmed a decree enjoining the commission from enforcing prescribed rates because of the method employed to ascertain

value, namely, by the use of price trend indices, rather than on the ground that the rate was confiscatory.

In April 1936, in St. Joseph Stock Yards Co. v. U. S., 298 U. S. 38, 53, the majority of the court again reviewed the distinctive functions of commission and court, saying that the "judicial duty to exercise an independent judgment does not require or justify disregard of the weight which may properly attach to findings upon hearing and evidence * * * Judicial judgment may be none the less appropriately independent because informed and aided by the sifting procedure of an expert legislative agency * * * We have said that 'in a question of rate-making there is a strong presumption in favor of the conclusions reached by an experienced administrative body after a full hearing' * * * The established principle which guides the court in the exercise of its judgment on the entire case is that the complaining party carries the burden of making a convincing showing and that the court will not interfere with the exercise of the ratemaking power unless confiscation is clearly established * * *."

In Railroad Commission of California v. Pacific G. & E. Co., 302 U. S. 388, the court, reemphasizing the principle from Los Angeles Gas Co. v. Railroad Commission, Lindheimer v. Illinois Tel. Co., West Ohio Gas Co. v. Public Utilities Com., and other cases, refused to consider as an error amounting to a denial of due process the commission's treatment of the company's estimate of reproduction costs as without probative value. The dissenting opinion of Justice Butler, who invoked application of the Smyth v. Ames rule, pointed out that the California Commission consistently refused to apply the Smyth v. Ames criteria.

Then in Federal Power Commission v. Natural Gas Pipeline Co., 315 U. S. 575 (March 1942), the court again appeared to approve nonadherence to the rule of Smyth v. Ames by utility commissions. It upheld an interim order of rate reduction by the Federal Power Commission, acting under the Natural Gas Act of 1938, 52 Stat. 821, 15 U. S. C. Sec. 717, which required that rates and charges for transportation and sale of gas in interstate commerce should be "just and reasonable." The gas company sought to have

$8,500,000 claimed going concern value included in the rate base. In upholding the commission the court said (p. 586): "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the progmatic adjustment which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. If the commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end."

Finally in Federal Power Commisison v. Hope Natural Gas Company, decided January 3, 1944, the court freed commissions from the necessity of following Smyth v. Ames. There the commission reduced gas rates. In testing the value of the utility property, it had omitted an item of $17,000,000 expended for drilling operations in an unregulated period of the utility's operations, and which in the same period had been recouped from earnings by having been charged off to operating expenses. The court rejected the contentions that the rate base should reflect the reproduction cost and trended original cost, and that the well drilling costs of $17,000,000 should have been included in the rate base. It said: "Rate-making is indeed but one species of price-fixing. Munn v. Illinois, 94 U. S. 113, 134. The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid * * * It does, however, indicate that 'fair value' is an end product of the process of rate-making not the starting point * * * The heart of the matter is that rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated.

"We held in Federal Power Commission v. Natural Gas Pipeline Co., supra, that the Commisison was not bound to

the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'progmatic adjustments.' Id., p. 586. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Id., p. 586. Under the statutory standard of 'just and reasonable' it is the result reached and not the method employed which is controlling. Cf. Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U. S. 287, 304-305, 314; West Ohio Gas Co. v. Commission (No. 1), 294 U. S. 63, 70; West v. Chesapeake & Potomac Tel. Co., 295 U. S. 662, 692-693 (dissenting opinion). It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences . . . The conditions under which more or less might be allowed are not important here. Nor is it important to this case to determine the various permissible ways in which any rate base on which the return is computed might be arrived at. For we are of the view that the end result in this case cannot be condemned under the Act as unjust and unreasonable from the investor or company viewpoint." Answering other contentions the court said: "Congress has entrusted the administration of the Act to the Commission not to the courts. Apart from the requirements of judicial review it is not for us to advise the Commission how to discharge its functions."

The petitioner contends that the cases of Federal Power Commission v. Natural Gas Pipeline Co. and Federal Power Commission v. Hope Natural Gas Company are inapplicable because they involved the commodity gas, as distinguished from the use of common carrier property. The petitioner

does not contend, however, that the rate base theory of public utility valuation is not applicable in the present case. That theory of evaluating public utility property as determinative of the question of confiscation was adopted by the commissions, and assumed by the court to be proper, in the cited cases. It follows that the holdings of the Supreme Court in those cases may be considered in a case involving common carriers. Therefore those cases, particularly the Supreme Court's decision in the Hope Natural Gas Company case, permits unreasonableness to be shown, not by the method employed to formulate a rate base, but by the fact that the "end result" of the commission's order interferes with the Company's successful operation, its financial integrity, its ability to maintain credit and attract capital, and to compensate investors for risks assumed—in short, fails to provide a return sufficient to induce the utility enterprise to "perform completely and efficiently its functions for the public." The Supreme Court refrained from endorsing a particular method of valuation to arrive at the result of reasonableness, but left commissions free to follow Smyth v. Ames, or to select one or more of the heretofore recognized criteria or a different method, which, even if irregular, would not invalidate an order unless unreasonableness were clearly established. Thus, responsibility for rate fixing, in so far as the law permits and requires, is placed with the commission, and unless its action is clearly shown to be confiscatory the courts will not interfere.

Section 32 of the Public Utilities Act (Stats. 1915 p. 115, as amended), empowers the California commission, after a hearing had upon its own motion or upon complaint, to make findings on the reasonableness of the rates charged by a public utility and to lower or increase the rates accordingly. By the same section the commission also has power and it is made its duty, after a hearing had on its own motion or on complaint, to determine the facilities and operation adequate to meet the public requirements, and to fix the just, reasonable and adequate rates for such service.

Section 67 of the Public Utilities Act provides for a review by this court for the purpose of having the lawfulness of the order and decision of the commission inquired into.

That section restricts the review to a determination of whether the commission has regularly pursued its authority, including a determination of whether the order or decision under review violates any right of the petitioner under the Constitution of the United States or of the State of California. It further provides that the findings and conclusions of the commission on questions of fact shall be final and shall not be subject to review except as hereinafter noted, and that such questions of fact shall include ultimate facts and the findings and conclusions of the commission on reasonableness and discrimination. The exception to finality is that "in any proceeding wherein the validity of any order or decision is challenged on the ground that it violates any right of petitioner under the Constitution of the United States, the Supreme Court shall exercise an independent judgment on the law and the facts, and the findings or conclusions of the Commission material to the determination of said constitutional question shall not be final." That section also gives the court power to enter judgment either affirming or setting aside the order or decision of the commission.

That part of section 67 which requires the independent judgment of the court on the law and the facts and withholds from the commission's findings and conclusions finality on constitutional questions, was added by amendment in 1933. This court thereafter recognized that the amendment was responsive to language in certain United States Supreme Court decisions which indicated that the legislature must provide the means whereby the courts should exercise an independent judgment on the law and the facts when Federal constitutional questions were involved. (Southern California Edison Co. v. Railroad Com., 6 Cal. 2d 737; American Toll Bridge Co. v. Railroad Com., 12 Cal. 2d 184.) The United States Supreme Court and this court assumed to exercise such judgment without statutory language, deeming it appropriate for the protection of constitutional rights; but in the exercise thereof, as variously stated in the decisions, the reviewing court refrains from sitting as a board of revision; and will not disturb the findings or conclusions of the regulatory body unless inva-

sion of constitutional rights is clearly established. In the Edison Company case this court pointed out that the amendment added nothing which was not theretofore a part of our state law; that it did not materially affect the procedure theretofore followed in a review under the Public Utilities Act, and did not make the court a trier of disputed questions of fact already resolved by the commission. We said: (p. 748) "If the mere challenge on federal constitutional grounds was intended by the amendment of 1933 to be sufficient to take the case out of the rule that the findings and conclusions of the commission in such cases should be final and beyond review, then we would have grave doubt of the power of the legislature thus to transfer to this court the traditional functions of the commission." In American Toll Bridge Co. v. Railroad Com., supra, it was again stated that the amendment did not change the scope of the judicial review.

In the present proceeding, as in the recent cases of Federal Power Commission v. Natural Gas Pipeline Co. and Federal Power Commission v. Hope Natural Gas Co., the standard for rate fixing is that of reasonableness. The petitioner herein must be charged with the burden of showing that the evidence does not support the commission's finding of value, and that the reduced rate is unreasonable and will result in confiscation of its property. That burden is coupled with a strong presumption of the correctness of the findings and conclusions of the commission. Ordinarily a public utility is a monopoly and is not subject to the travail of competition. Because of its monopolistic character, public interest requires that it submit to regulation for the protection of the consumer, and the utility in return is entitled to protection of its investor interest. In the case of monopolistic utilities it is possible to say that regulation to accomplish the two-fold purpose may be a relatively simple matter. But here the commission was confronted with facts which are unusual in utility rate regulation. It was faced with the problem of evaluating the property of a utility which was in direct competition with a municipal utility offering similar service in the same community, in large part serving the same territory, and over which the

commission had no regulatory power. From the year 1912, when a competitive system of street car operation was established in San Francisco under municipal regulation, such obstacles to profitable operation by the commission regulated utility were created that commission regulation in effect gave way to regulation by competition. The evidence is clear that during the early competitive period and until the abnormal stimulation in public use brought about by the present world war, competition necessitated operation at a loss. Since the commencement of competition the company has not devoted to replacement and repair the amounts charged off on its books for those purposes, and its charges to depreciation reserve were lower than the actual annual plant consumption. In this connection it is significant that for tax purposes the company's accrued depreciation figure was shown to be $26,834,000, and its total depreciation reserve figure only $9,902,000. The factors which affected the value of the investment in this case justified the commission in refusing to follow the practice of adopting as an annual charge to plant consumption the company's book depreciation reserve or any other hypothetical sum approved by accounting practices. The evidence supports the conclusion that the company permitted unusual deterioration in view of negotiations for sale to the city started many years ago. The ordinary methods or theories of depreciation accounting therefore would not reflect the true record of the past annual plant consumption and the result, were such methods adopted, would not be in conformity with the facts. On the other hand, the evidence of obsolescence, depletion, depreciation and deterioration is such as to justify the commission's observation that there was no available or procurable evidence of the fair value of the property except the amount contained in the company's offer to sell to the city, made in the period when the business was profitable. Acceptance of the company's book figures or of the amount of outstanding capitalization, in order to arrive at the present worth of the properties, would result in a figure inflated so far above fair value as to impede the commission's authorized regulatory effort to restore the company as a useful public servant

performing its functions adequately. Capitalization in any event has little relation to the depreciated value of the investment. Also going concern value can have little if any place in the rate base under the facts except as the special factor of competition has so affected that value as to indicate it at nil. Separate appraisal of the going concern element is not required. (Federal Power Com. v. Natural Gas Pipeline Co., supra.)

It cannot be said that under the facts of this case arbitrary action resulted merely from the commission's rejection of book values and capitalization, its refusal to make precise estimates of actual deterioration, of going concern or other values, and its acceptance of the company's offer of sale to the city made in a profitable period as the best evidence of the fair value of the utility in the present condition of its operative properties. The commission expressly refrained from considering whether the amount of the offer in relation to value under all the conditions was not too high. Furthermore, it appears that studies of valuation for sale purposes were also made by the city and by the commission, and only after such studies was a sale price selected which was deemed commensurate with the fair value of the property under existing conditions.

It is the real and not the nominal paper valuation that determines the amount of the investment on which the utility is entitled to a return. (See Pond, Public Utilities, Fourth Ed., Vol. 2, pp. 1117, 1118.) As said in Lindheimer v. Illinois Tel. Co., 292 U. S. 151, the "actual experience of the company is more convincing than tabulations of estimates * * * Elaborate calculations which are at war with realities are of no avail." There is no fundamental or statutory law which will preclude the commission from evaluating a public utility in accordance with the actualities. So to proceed is not to take private property for public use without compensation. There is no denial of due process in rejecting conjectural and unsatisfactory estimates of value, or in treating the petitioner's estimates as without probative value. (Railroad Com. of Calif. v. Pacific G. & E. Co., 302 U. S. 388, 397-398.) As was said in Los Angeles Gas Co. v. Railroad Com., 289 U. S. 287,

306, "The public have not underwritten the investment. The property, on any admissible standard of present value, may be worth more or less than it actually cost. The time and circumstances of the outlay, and the effect of altered conditions demand consideration."

The petitioner has not shown that the results are not in accord with the realities. Both before the commission and in this court it contented itself merely with urging that the commission proceeded erroneously in selecting for rate making purposes the offer price of $7,950,000, because, so it claims, that figure was based on a capitalization of earnings. The petitioner made no offer or attempt to show that the value fixed by the Commission did not represent either the true depreciated legitimate cost or the true depreciated actual cost. In Minnesota Rate Cases, 230 U. S. 352, 566, it was said that "the company having assailed the constitutionality of the state acts and orders was bound to establish its case, and it was not entitled to rest on expressions of judgment when it had it in its power to present accurate data which would permit the court to draw the right conclusion." Since it is impossible to say in the light of the evidence in this proceeding that the figure selected by the commission does not bear a proper relation to the fair value of the utility under existing conditions, it must be concluded that the petitioner has not shown arbitrary action on the part of the commission in selecting the sale offer price as the rate base, or that the evidence does not support the commission's finding that the figure selected represents at least fair value, if not more than that.

The petitioner has also failed to meet the burden cast upon it to establish that the return on the rate base under the reduced fare will prevent the utility's functioning adequately from the company or investor standpoint. The commission has the experience and the data at hand from which to cull the estimates of probable increase in traffic under a reduced fare and improved service, and of the probable future operating revenues, expenses, and other costs. This court will not disturb its findings on those disputed questions of fact. The company is now and for

several years has been doing an abnormally increased traffic business with returns greatly in excess of its operating costs plus increased reserves for depreciation and taxes. It does not question that under a seven cent fare it has enjoyed a return of more than a fair percentage above the constitutional line of confiscation on the fair value as found by the commission. Nor is it questioned that a return of six per cent on the value of its capital investment is unconstitutional. The petitioner claims that the commission's estimates are false, and that falsity resides in the fact that at the prevailing cost per head for passenger transportation, it will suffer a deficit on the estimated volume of increased traffic at the six cent fare. The fallacy, however, is in the assumption that the cost ratio under the six cent fare will be the same as under the seven cent fare. The commission answers that the assumption is not true, inasmuch as the increase in traffic is expected, not necessarily in the peak hours, but in large part from the patronage in off hours which was diverted to Municipal Railway, or discontinued upon the inception of the higher rate, and which is expected to be regained materially upon the reduction of the fare and the improvement of the service. The petitioner also claims that the commission did not consider the evidence of a probable increase in labor costs pursuant to pending negotiations with labor unions. The commission on the other hand states that it did give consideration to that element. The commission's figures, with increased allowances for operating expenses, depreciation and taxes, must be deemed to resolve these disputed points adversely to the petitioner. "Long operation and adequate records make forecasts of net operating revenues fairly certain." (Driscoll v. Edison Co., 307 U. S. 104, 120.)

The foregoing discussion demonstrates that the interests of the investor have received constitutional protection by the action of the commission. Under rule by competition and the consequent great deterioration in its capital investment, the utility's ability to attract capital has undoubtedly suffered. But this is not an element that can be

controlled by the regulatory body beyond the possibility of insuring to the utility a fair return on the value of the capital investment when business is profitable. The fact that the utility has suffered deficits in the past does not justify excessive profits in the future. (Los Angeles Gas Co. v. Railroad Com., 289 U. S. 287, 313; Federal Power Com. v. Natural Gas Pipeline Co., 315 U. S. 575, 590.) "When a business disintegrates, there is damage to the stockholders, but damage also to the customers in the cost of quality of service." (West Ohio Gas Co. v. Comm. (No. 1), 294 U. S. 63, 72.)

The record is also clear that the commission has not been arbitrary in acting for the protection of the public which is under compulsion to use the present depleted and inadequate service, or which may be expected to make use of an improved service. As the commission said in its opinion, "After making such allowance [for war time difficulties] the important question remains to what extent the ratepayer, under war conditions, should be compelled to pay the same or higher rates for an inadequate and inferior service while the utility enjoys abnormal profits." It is unnecessary to consider whether the seven cent fare would still be unreasonable were the petitioner performing a fully adequate and efficient service. The findings of inadequacy in the maintenance and service are supported by the evidence. The commission is empowered under the statute in fixing the fare to take into consideration the quality of the facilities and service. The commission decided that even in war time improvement was possible, and that the value of the improved service would be no more than six cents. The problem of the value of the service, and the correctness of the commission's decision on the consumer interest, do not involve constitutional questions, so long as otherwise the investor or company interest has received adequate consideration by the commission. When the company interest has received constitutional protection, the findings of the commission on the consumer interest become final in the proceeding. The question involving that interest then has been answered by the commission correctly pursuant to the

statute and the authorities to the effect that the reasonableness of rates should not be considered apart from the adequacy of the service, and that the public should not be charged more than the service is reasonably worth. The statute is a legislative recognition of the public's right to demand that consideration be given to the value of the service. (Covington etc. Turnpike Co. v. Sandford, 164 U. S. 578, 596; Spring Valley Water Works v. San Francisco, 192 Fed. 137; see Article, Value of the Service as a Factor in Rate-Making, 32 Har. Law Rev. 516.)

In the final analysis the question whether the right to just compensation for the service rendered has been denied to the utility depends upon the special facts in the case. (The Minnesota Rate Cases, 230 U. S. 352, 434.) Each case must be controlled by its own circumstances. (Los Angeles Gas Co. v. Railroad Com., 289 U. S. 287, 315.) Pragmatic adjustments depend upon the particular facts. (Federal Power Com. v. Natural Gas Pipeline Co., supra.) It does not apear from the facts in this record that the rate fixed by the commission is so unreasonably low as to call for a declaration that Market Street Railway Company has been deprived of its property without due process of law or without just compensation.

The petitioner asserts some errors in the admission and consideration of statistical and other documentary evidence. It is not the function of the reviewing tribunal in these proceedings to set aside the legislative finding for mere errors of procedure not amounting to lack of due process. Its duty is to ascertain whether the legislative process has resulted in confiscation. (West v. C. & P. Tel. Co,, 295 U. S. 662, 674.)

The petitioner objects to the apparent indeterminate duration of the experimental period under the six cent fare fixed by the commission. The commission still has jurisdiction and if from the monthly reports filed by the company during a reasonable experimental period it appears that the expected increase in passenger traffic on the utility's system due to the reduction in fare and improvement in service does not materialize, the commission has

the power to make appropriate adjustments. As the prescribed rate is expressly stated to be tentative, there is no ground for assuming that the commission will reject an application to make such changes as experience may show to be necessary in order to produce the stipulated revenue. (Clark's Ferry Co. v. Commission, 291 U. S. 227, 241.)

The order is affirmed.

SHENK, *J.*

We Concur: Gibson, C. J.; Curtis, J.; Edmonds, J.; Carter, J.; Traynor, J.; Schauer, J.